# CERTIFICATE

## SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1925

No. 120

EPHRAIM LEDERER, FORMERLY COLLECTOR OF INTERNAL REVENUE

vs.

MARY A. McGARVEY, EXECUTRIX OF THE ESTATE OF FRANCIS O'KANE

ON CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

FILED JULY 1, 1924

(30461)

# SUPREME COURT OF THE UNITED STATES

## OCTOBER TERM, 1925

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## No. 120

EPHRAIM LEDERER, FORMERLY COLLECTOR OF INTERNAL REVENUE

vs.

MARY A. McGARVEY, EXECUTRIX OF THE ESTATE OF FRANCIS O'KANE

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ON CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

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1 In United States Circuit Court of Appeals for the Third Circuit

October term, 1923

EPHRAIM LEDERER, FORMERLY COLLECTOR OF INTERNAL revenue, defendant below, plaintiff in error
*vs.*
MARY A. McGARVEY, EXECUTRIX OF THE ESTATE OF FRANCIS O' KANE, plaintiff below, defendant in error
No. 3093

In error to the District Court of the United States for the Eastern District of Pennsylvania

Before WOOLLEY and DAVIS, Circuit Judges, and GIBSON, District Judge

*Statement of facts*

Certificate to the Supreme Court—filed June 25, 1924

In order to be guided to a proper decision of this case the Circuit Court of Appeals for the Third Circuit desires the instruction of the Supreme Court, and therefore, under authority of section 239 of the Judicial Code, certifies two questions of law arising from the following facts:

Section 6 of the act of Congress of October 28, 1919, 41 Stat. 305, generally known as the national prohibition act, provides that—

No one shall manufacture, sell, purchase, transport, or prescribe any liquor without first obtaining a permit from the commissioner so to do, * * *.

"The commissioner may prescribe the form of all permits and applications and the facts to be set forth therein. Before any permit is granted the commissioner may require a bond in such form and amount as he may prescribe to insure compliance with the terms of the permit and the provisions of this title."

Under this provision of the statute, the Bureau of Internal Revenue of the Treasury Department, acting through the Federal prohibition commissioner with the approval of the Secretary of the Treasury, given January 16, 1902, promulgated Regulations 60 relative to the sale and purchase of intoxicating liquor under Title II of the act. Section 20 of the regulations reads as follows:

"All persons desiring to obtain permits provided by these regulations, except as provided below, must at or before the time of filing application therefor, file with the director a bond in duplicate on Form 1408 or Form 1409 to insure compliance with the provisions of this act and of these regulations as well as to cover any taxes and penalties which may be imposed under the internal revenue laws. * * *

"(a) Except where otherwise provided, the basis of the penal sum of such bond will be as follows:

"$4.20 per proof gallon on distilled spirits and $100 for each 200 gallons, or fractional part thereof, on wine, malt liquor, cider, or other liquor, manufactured or received during any quarterly period of the calendar year plus the quantity on hand at the end of the preceding quarterly period. In no case shall the penal sum of any bond be less than $1,000 nor more than $100,000.

"(b) * * *

"(c) Where holders of permits to use or sell nonbeverage spirits or wines have given bond as provided in Treasury Decision 2940 and Treasury Decision 2946, and such bonds are in sufficient penal sum, no new bonds need be furnished until such persons are called upon by the directors to make applications for new permits, as provided in section 17, when they will be required to file new bonds on Form 1408 or Form 1409."

Conformably with the cited regulations, Francis O'Kane on February 17, 1920, applied for a permit "to sell distilled spirits and wines for other than beverage purposes," and filed with his application a bond, executed February 7, 1920, for $2,000, following Form 738. The bond reads as follows:

"Know all men by these presents, that Francis O'Kane, of Philadelphia, Pennsylvania, as principal, and Maryland Casualty Company, of Baltimore, Maryland, as surety, are held and firmly bound unto the United States of America in the sum of two thousand dollars, lawful money of the United States, for payment whereof to the United States we bind ourselves, our heirs, executors, administrators, successors or assigns, jointly and severally, firmly by these presents.

3 "Whereas the above-bounden principal has made application for a permit to use and sell distilled spirits and wines for other than beverage purposes at 701 So. 15th Street, Philadelphia, Pennsylvania,

"Now, therefore, the condition of this obligation is such that if the said principal shall fully and faithfully comply with the requirements of the laws of the United States now or hereafter enacted and regulations issued pursuant thereto, respecting the sale or use of distilled spirits and wines for other than beverage purposes, then this obligation to be void; otherwise to remain in full force and virtue."

Bond Form 738, under which the aforegoing bond was drawn, was originally prescribed in connection with the enforcement of the provisions of sections 15 and 16 of the food control act of 1917, promulgated as a part of Treasury Decision 2559, approved October 26, 1917.

Treasury Decision 2559 provides as follows:

"Any violations of these regulations will subject the offender to the penalty provided by the statute, to wit, a fine not exceeding $5,000, or imprisonment for not more than two years, or both, and to the

pains and penalties denounced by statute for violation of the internal revenue laws as well as to liability on his bond."

Treasury Decision 2788, approved February 6, 1919, provided an amended form of internal revenue bond (Form 739), which reads as follows:

"Any person who violates these regulations is subject to the penalties provided by the act of August 10, 1917, the act of November 21, 1918, and the revenue act of 1918, as well as to liability on his bond."

These sections of Treasury Decisions 2559 and 2788 were continued in force by Treasury Decision 2940.

On March 15, 1920, the prohibition commissioner issued to O'Kane a permit on Form 1405 by which he was "authorized and permitted to sell intoxicating liquors for other than beverage purposes, to wit: To others holding permits which confer authority to purchase and use intoxicating liquors for nonbeverage purposes. * * * This permit is granted under the conditions that the provisions of national prohibition act and regulations issued thereunder will be strictly observed."

4 With this permit in hand, O'Kane admittedly sold three barrels of whiskey to a pharmacy having no permit to purchase whiskey and, further, failed to keep Form 52 as provided by Regulations 60, in violation of the national prohibition act and the regulations thereof. Accordingly the Commissioner of Internal Revenue assessed against him taxes amounting to $1,140.39, of which $1,098.72 represent a differential tax at $8.40 per gallon (double the figure named in section 20 of the regulations) on 130.8 proof gallons, under the provisions of section 600 of the revenue act of 1918, approved February 24, 1919, and $41.67 represent penalties under section 3244 R. S. and section 3176 R. S., as amended. O'Kane paid these taxes under protest and filed a claim for refund. The commissioner rejected the claim in the amount of $41.67 but allowed it in the amount of $1,098.72, with interest, on an opinion by the Attorney General of the United States, rendered after the assessment of the taxes in question, to the effect that the national prohibition act allows permits of this kind only to manufacturers and distillers. O'Kane then brought this suit in the District Court against the Collector of Internal Revenue to recover both the sum rejected and the sum allowed on his claim for refund as taxes illegally assessed and collected. The collector filed an affidavit of defense in which he conceded the plaintiff's claim as previously allowed by the commissioner but opposed recovery by a counterclaim for $2,000 which he set up on the plaintiff's bond, alleging the beforementioned breaches of its condition, that the plaintiff, as principal, had violated the law by the sale of whiskey to one without a permit to purchase whiskey and had violated the regulations by not keeping Form 52 as thereby required. On motion the court issued a rule to show cause why judgment for the plaintiff should not be entered for want of a sufficient affidavit of defense. This proceeding, under

Pennsylvania practice, is in the nature of a demurrer. At the hearing the defendant collector took the position that the bond
5 which the plaintiff gave the United States, being conditioned, as before stated, to "comply with the requirements of the laws of the United States * * * and regulations issued pursuant thereto," is, upon violation of the law and regulations, forfeitable in the full amount of its penal sum—in the nature of a statutory penalty—and that recovery is not limited merely to the amount of the taxes due the United States by reason of such violation. The District Court was inclined to this contention, had the condition of the bond been directed only to faithful compliance with the laws of the United States, but, in view of the dual aspect of the condition, which, besides requiring compliance with the laws, extends as well to compliance with "regulations issued pursuant thereto," and in view of the fact that these regulations, as shown by section 29 thereof, call for a bond "to cover any taxes and penalties which may be imposed under the internal revenue laws," the court held, in line with the plaintiff's contention, that liability on the particular bond under consideration, read in connection with the regulations under which it was executed, is not to be measured by the penalty but is limited to the actual damages sustained and proved. As the commissioner found that certain of the taxes here sued for had been illegally assessed and collected and should be refunded, no damages were shown. Accordingly, the court made the rule absolute and entered judgment for the plaintiff for the amount of the differential tax, with interest. To this judgment the Collector of Internal Revenue, the defendant below, has directed this writ of error.

*Questions certified*

The questions of law upon which the Circuit Court of Appeals desires the instructions of the Supreme Court are these:

(1) Is a bond conditioned upon compliance with the laws of the United States and regulations issued pursuant thereto, respecting the sale or use of distilled spirits and wines for other than beverage purposes, given the United States by one to whom a permit to sell intoxicating liquors for other than beverage purposes has been
6 issued under the provisions of section 6 of Title II of the national prohibition act and regulations promulgated thereunder, forfeitable upon breach of the condition in the full amount of its penal sum?

(2) Is recovery upon breach of the condition of such a bond given by one holding such a permit limited to actual damages sustained by the United States?

VICTOR B. WOOLLEY,
J. WARREN DAVIS,
*Circuit Judges.*
ROBERT M. GIBSON,
*District Judge.*

[File indorsement omitted.]

7 In United States Circuit Court of Appeals

*Clerk's certificate*

I, Saunders Lewis, jr., clerk of the United States Circuit Court of Appeals for the Third Circuit, do hereby certify the foregoing to be a true and faithful copy of the original certificate of questions to be submitted to the Supreme Court in the case of Ephraim Lederer, collector of internal revenue, plaintiff in error, vs. Mary A. McGarvey, executrix of the estate of Francis O'Kane, defendant in error, No. 3093, on file, and now remaining among the records of the said court in my office.

In testimony whereof I have hereunto subscribed my name and affixed the seal of the said court, at Philadelphia, this 25th day of June, in the year of our Lord one thousand nine hundred and twenty-four and of the independence of the United States the one hundred and forty-eighth.

[SEAL.] SAUNDERS LEWIS, jr.,
*Clerk of the U. S. Circuit Court of Appeals, Third Circuit.*

(Indorsed on cover:) File No. 30461. U. S. Circuit Court of Appeals, Third Circuit. Term No. 120. Ephraim Lederer, formerly collector of internal revenue, vs. Mary A. McGarvey, executrix of the estate of Francis O'Kane. (Certificate.) Filed July 1st, 1924. File No. 30461.

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# CERTIFICATE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1925

No. 790

THE UNITED STATES OF AMERICA

vs.

JOHN E. ZERBEY AND NATIONAL SURETY COMPANY

ON CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

FILED OCTOBER 29, 1925

# SUPREME COURT OF THE UNITED STATES

## OCTOBER TERM, 1925

## No. 790

THE UNITED STATES OF AMERICA

vs.

JOHN E. ZERBEY AND NATIONAL SURETY COMPANY

ON CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

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1 In United States Circuit Court of Appeals for the Third Circuit

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| UNITED STATES OF AMERICA, PLAINTIFF BELOW, plaintiff in error, vs. JOHN E. ZERBEY AND NATIONAL SURETY COMPANY, a Corporation of the State of New York, defendants below, defendants in error | No. 3303 March term, 1925 |

In error to the District Court of the United States for the Middle District of Pennsylvania

Before Buffington, Woolley, and Davis, circuit judges.

*Statement of case*

In order to be guided to a proper decision of this case the Circuit Court of Appeals for the Third Circuit desires the instruction of the Supreme Court, and, therefore, under authority of section 239 of the Judicial Code, certifies two questions of law arising from the following facts:

Section 6 of the act of Congress of October 28, 1919, 41 Stat. 305, generally known as the national prohibition act, provides that, "No one shall manufacture, sell purchase, transport, or prescribe any liquor without first obtaining a permit from the commissioner so to do. * * *

2 "The commissioner may prescribe the form of all permits and applications and the facts to be set forth therein. Before any permit is granted the commissioner may require a bond in such form and amount as he may prescribe to insure compliance with the terms of the permit and the provisions of this title."

Treasury Decision 2940, as amended by Treasury Decision 2946, both promulgated by the Commissioner of Internal Revenue to carry into effect the foregoing as well as other statutory provisions, provided in article 15:

"(b) The applicant, before or at the time of filing application for permit, is required to furnish a bond, in duplicate, conditioned that he shall fully and faithfully comply with the laws of the United States now or hereafter enacted, and all regulations issued pursuant thereto, respecting the sale or use of distilled spirits or wines for other than beverage purposes. * * *

"(f) The basis of the penal sum of the bond, Form 738 or 738A, covering the use or sale of nonbeverage spirits, is $4.20 per proof gallon on the quantity of spirits which will be received during any quarterly period of the calendar year, plus the amount of nonbeverage spirits on hand at the end of the preceding quarter.

"The penal sum of bonds covering wines will be computed at the rate of $100 for each 200 gallons, or any fractional part thereof.

which will be received during any quarterly period of the calendar year, plus the amount on hand at the end of the preceding quarter.

"The penal sum of a bond to cover both nonbeverage spirits and wines shall be the aggregate sum of the amounts required for each: Provided, however, That the penal sum of any bond shall not be less than $1,000 nor more than $100,000."

Conformably with the cited regulations, John E. Zerbey, on January 23, 1920, applied for a permit "to sell distilled spirits and wines for other than beverage purposes to others holding like permits," and filed with his application a bond for $100,000, bearing the same date and executed upon Form 738. The bond reads as follows:

"Know all men by these presents, that John E. Zerbey of Summit Hill, Pa., as principal and National Surety Company of New York City, N. Y., as surety, are held and firmly bound unto the United States of America in the sum of one hundred thousand ($100,000.00) dollars, lawful money of the United States, for the payment whereof to the United States we bind ourselves, our heirs, executors, administrators, successors, or assigns, jointly and severally, firmly by these presents:

"Whereas the above-bounden principal has made application for a permit to use and sell distilled spirits and wines for other than beverage purposes at Summit Hill, Penna., in the 12th collection district of Pennsylvania:

"Now, therefore, the condition of this obligation is such that if the said principal shall fully and faithfully comply with all the requirements of the laws of the United States now or hereafter enacted and regulations issued pursuant thereto, respecting the sale or use of distilled spirits and wines, for other than beverage purposes, then this obligation to be void; otherwise to remain in full force and virtue."

3 Form 738, upon which the foregoing bond was executed, was prescribed by Treasury Decision 2940. This form of bond was originally prescribed in connection with the enforcement of the provisions of sections 15 and 16 of the food control act of 1917, promulgated as a part of Treasury Decision 2559, approved October 26, 1917.

Treasury Decision 2559 provides as follows:

"Any violations of these regulations will subject the offender to the penalty provided by the statute, to wit: A fine not exceeding $5,000, or imprisonment for not more than two years, or both, and to the pains and penalties denounced by the statute for violation of the internal revenue laws as well as to liability on his bond."

The quoted provisions of the Treasury Decision 2559 were continued in force by Treasury Decision 2940.

On January 26, 1920, the Federal Prohibition Commissioner, acting under and by virtue of the authority of the Commissioner of Internal Revenue, issued to Zerbey a permit on Form 1405 reciting:

"Application having been duly presented and approved, you are hereby authorized and permitted to sell intoxicating liquors for

other than beverage purposes, to wit: To others holding permits which confer authority to purchase and use intoxicating liquors for nonbeverage purposes. * * * This permit is granted under the conditions that the provisions of the national prohibition act, and regulations issued thereunder will be strictly observed."

By section 10 of the national prohibition act it is commanded that no person shall manufacture, purchase for sale, sell, or transport any liquor without making at the time a permanent record of the transaction, and the Commissioner of Internal Revenue is therein authorized to prescribe the form of such record. Pursuant to this authority the commissioner provided by section 58 of regulations, 60, issued under date of February 1, 1920, that:

"(e) All persons dealing in intoxicating liquors are required to keep Record 52 and supplementary Record 52, containing detailed entries covering all receipts and deliveries of liquor by them, and to keep a permanent file containing a copy of each permit to purchase upon which deliveries of intoxicating liquor are made to or by them."

With the aforesaid permit in his possession unrevoked, Zerbey, between March 6, 1920, and July 30, 1920, it is alleged, violated the condition of his bond in the following respects among others: He (a) failed and neglected to keep records of the sales made by him of distilled spirits, as provided in section 10 of the national prohibition act and section 58 of Regulations, 60; (b) sold and
4 disposed of a large quantity of distilled spirits for beverage purposes; (c) diverted a large quantity of distilled spirits to other than nonbeverage purposes, and (d) had in his possession upon his premises about 36 barrels of whiskey which had been withdrawn, for nonbeverage purposes only, from a bonded warehouse subsequent to the effective date of the national prohibition act, of which distilled spirits no record was kept by him as required by section 10 of the national prohibition act and by section 58 of Regulations, 60.

Notice of these breaches of the condition of the bond was given to Zerbey and to the National Surety Company and due demand was made upon them for the payment of the amount of the bond. No part of the sum demanded having been paid, the United States brought this action in the District Court against Zerbey and the Surety Company to recover the full penal sum of the bond, it being alleged in the statement of claim that said sum had been forfeited and was due and owing by the defendants to the United States by reason of the aforesaid breaches of the condition of such bond. The statement of claim contained no allegation of any damage or pecuniary loss sustained by the United States as a result of the alleged breaches of condition.

To the plaintiff's statement of claim, the defendants, jointly and severally, filed affidavits of defense, raising questions of law, which

under the Pennsylvania practice act constituted a demurrer, wherein they asked the judgment of the court upon the following questions of law:

"1. Even if the bond given by the defendants has been breached, the Government is not merely by virtue of any breach entitled to recover the full amount of the bond, that full amount being but the penal sum and the maximum limit of recovery; all that the Government can recover is a sufficient amount to indemnify it for its actual financial loss, injury, or damage suffered and incurred on account or by reason of such breach or breaches. * * *

"4. There can be no recovery in this suit on the bond sued on because it is not a forfeiture bond."

In a memorandum opinion the court stated, in substance, that the question involved was whether the breaches of the condition of the bond rendered the defendants liable for the full amount of its penal sum, or whether the recovery should be limited to the actual damages sustained by the obligee; that if the bond was a forfeiture bond the full penalty was incurred upon a breach of its condition and the action could be sustained provided the facts pertaining to the alleged breach were made to appear to the satisfaction of the court and jury, but if the bond was not a forfeiture bond the action could not be sustained, under the pleadings, as no pecuniary loss or damage was alleged to have been suffered by reason of the breaches charged. Although observing that the question had been variously answered and was not free from doubt, the court was persuaded to follow the decisions in certain cases which it cited, holding that the United States could not recover the full penal sum of a Form 738 bond, but only such loss or damage as it should establish had been sustained by it in consequence of the breach or breaches of the condition of such bond. The statutory demurrers were accordingly sustained and judgment was directed to be entered dismissing the action. To review that judgment the United States has brought the case to this court on writ of error.

The questions of law upon which the Circuit Court of Appeals desires the instruction of the Supreme Court are these:

*Questions certified*

(1) Is a bond conditioned upon compliance with the law of the United States and regulations issued pursuant thereto, respecting the sale or use of distilled spirits and wines for other than beverage purposes, given the United States by one to whom a permit to sell intoxicating liquors for other than beverage purposes has been issued under the provisions of section 6 of Title II of the national prohibition act and regulations promulgated thereunder, forfeitable upon breach of the condition in the full amount of its penal sum?

6 (2) Is recovery upon breach of the condition of such a bond given by one holding such a permit limited to actual damages sustained by the United States?

JOSEPH BUFFINGTON,
*Circuit Judge.*
VICTOR B. WOOLLEY,
*Circuit Judge.*
J. WARREN DAVIS,
*Circuit Judge.*

(Endorsements: 3303 Certificate of questions for submission to Supreme Court. Received and filed Oct. 7, 1925. Saunders Lewis, jr., clerk.)

1x In United States Circuit Court of Appeals

*Clerk's Certificate*

I, Saunders Lewis, jr., Clerk of the United States Circuit Court of Appeals, for the Third Circuit, do hereby certify the foregoing to be a true and faithful copy of the original certificate of questions for submission to Supreme Court in the case of [title omitted] on file, and now remaining among the records of the said court, in my office.

In testimony whereof, I have hereunto subscribed my name and affixed the seal of the said court, at Philadelphia, this 7th day of October, in the year of our Lord one thousand nine hundred and twenty-five and of the independence of the United States the one hundred and fiftieth.

[SEAL.] SAUNDERS LEWIS, Jr.,
*Clerk of the U. S. Circuit Court of Appeals, Third Circuit.*

(Indorsed on cover: File No. 31513. U. S. Circuit Court of Appeals, Third Circuit. Term No. 790. The United States of America vs. John E. Zerbey and National Surety Company. [Certificate.] Filed October 29th, 1925. File No. 31513.)

WASHINGTON : GOVERNMENT PRINTING OFFICE : 1926

# In the Supreme Court of the United States

OCTOBER TERM, 1925

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Nos. 120, 790

EPHRAIM LEDERER, FORMERLY COLLECTOR, ETC.

*v.*

MARY A. McGARVEY, EXECUTRIX, ETC.

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THE UNITED STATES

*v.*

JOHN E. ZERBEY AND NATIONAL SURETY COMPANY, a Corporation of the State of New York

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*ON CERTIFICATES FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT*

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**MOTION TO ADVANCE NO. 790 FOR ARGUMENT WITH NO. 120 AND TO HAVE BOTH CASES SET FOR HEARING ON A DAY CERTAIN**

Comes now the Solicitor General and moves to advance case No. 790, *The United States* v. *John E. Zerbey and National Surety Company*, for oral argument with case No. 120, *Lederer, Formerly Collector*, v. *McGarvey, Executrix of O'Kane*, and to set both cases for hearing on Monday, March 1st next, or as soon thereafter as convenient to

the Court. This motion is based upon the following grounds:

Both cases are in this Court on certificate from the Circuit Court of Appeals for the Third Circuit and present precisely the same questions, namely, whether a permit bond on Form 738, executed under the National Prohibition Act and regulations made pursuant thereto, is a forfeiture bond so as to enable the United States to recover the full amount named in the bond in the event of a breach of its condition, or is a mere indemnity bond restricting recovery to the actual damages shown by the United States to have resulted to it from such breach.

In the *Lederer case* the action was begun in the District Court of the United States for the Eastern District of Pennsylvania by Francis O'Kane to recover from Ephraim Lederer, former Collector of Internal Revenue, certain revenue taxes and a penalty alleged to have been unlawfully assessed against the plaintiff by the defendant, acting as such Collector, and paid by the plaintiff under protest. Defending the action Lederer filed an affidavit of defense and counterclaim in which he conceded that all but a small part of the sum sued for by O'Kane had been unlawfully assessed, but nevertheless opposed any recovery on the ground that O'Kane had breached the condition of a permit bond executed by him on Form 738 and was accordingly indebted to the United States

in the full penal sum of the bond, which exceeded the amount of O'Kane's claim. A demurrer to this pleading was sustained by the District Court on the ground that the bond in question was a mere indemnity bond, for breach of which the United States could recover only such damages as it should show had been suffered by it in consequence of said breach, and as the affidavit of defense failed to allege any damage resulting from the breach it did not set up any valid counterclaim or defense to the action. Lederer elected to stand on his pleading, and as O'Kane did not press his claim for the small amount which Lederer insisted had been properly assessed, the District Court gave judgment for the plaintiff for the amount conceded by the defendant to have been illegally assessed. Upon writ of error sued out by Lederer the Circuit Court of Appeals certified to this Court the following questions:

> 1. Is a bond conditioned upon compliance with the law of the United States and regulations issued pursuant thereto, respecting the sale or use of distilled spirits and wines for other than beverage purposes, given the United States by one to whom a permit to sell intoxicating liquors for other than beverage purpose has been issued under the provisions of Section 6 of Title II of the National Prohibition Act and regulations promulgated thereunder, forfeitable upon breach of the condition in the full amount of its penal sum?

2. Is recovery upon breach of the condition of such a bond given by one holding such a permit limited to actual damages sustained by the United States?

In the *Zerbey* case the United States filed its statement of claim in the District Court of the United States for the Middle District of Pennsylvania for the recovery from Zerbey and the National Surety Company, his surety, of the full amount named in a Form 738 permit bond executed by Zerbey and the condition of which it was alleged he had breached. The District Court sustained a demurrer to the statement of claim, holding that the bond was not a forfeiture bond but a mere indemnity bond, and that, as under the pleadings no pecuniary loss or damage was alleged to have been suffered by reason of the alleged breach, the action could not be maintained. The statement of claim was accordingly dismissed, and the United States took the case on writ of error to the Circuit Court of Appeals, which has certified to this court questions identical with those certified in the *Lederer case*.

In view of the decision of this Court in *Sage* v. *United States*, 250 U. S. 33, it is doubtful that Lederer had the right, in the action brought against him by O'Kane, to set up as a counterclaim an obligation alleged to be due and owing to the United States. Apprehending that this Court might regard the bond questions as not involved in the *Lederer case*, and therefore decline

to answer the questions certified therein, the Government pressed action in the lower courts in the *Zerbey case,* wherein the same questions were unmistakably involved, in order that if the certificate in the *Lederer case* should be dismissed a decision by this Court of these questions might not be unduly delayed.

An early decision by this Court of these bond questions is of very great importance to the Government in its administration of the prohibition and revenue laws. Court proceedings in many similar cases are being held in abeyance pending such decision, which will also determine the rights of the Government in bonds, bearing like conditions, aggregating potential liabilities of many millions of dollars.

Because of the apparent defect in the *Lederer case* certificate the Government will be content to present its argument to this Court in that case by brief only. As, however, the many thousands of these Form 738 bonds, as well as of other bonds having similar conditions, which are outstanding, will be valueless unless the Government can sustain its contention that they are penal bonds as distinguished from mere indemnity bonds, because it can not show that the United States suffers any pecuniary loss from their breach, the questions certified are regarded by the Government as of such gravity as to require oral argument in the *Zerbey case* for the full time allowed by the rules

in cases in which questions have been certified to this court.

Notice of this motion has been served on opposing counsel.

Respectfully submitted.

WILLIAM D. MITCHELL,
*Solicitor General.*

MABEL W. WILLEBRANDT,
*Assistant Attorney General.*

OCTOBER, 1925.

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# In the Supreme Court of the United States

OCTOBER TERM, 1925

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Nos. 120, 790

EPHRAIM LEDERER, FORMERLY COLLECTOR OF INTERNAL REVENUE

*v.*

MARY A. McGARVEY, EXECUTRIX OF THE ESTATE OF Francis O'Kane

---

THE UNITED STATES

*v.*

JOHN E. ZERBEY AND NATIONAL SURETY COMPANY, a corporation of the State of New York

---

*ON CERTIFICATES FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT*

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## BRIEF FOR THE UNITED STATES

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The above-styled cases come before this Court on certification by the Circuit Court of Appeals for the Third Circuit, under Section 239 of the Judicial Code, of the questions whether a permit bond on Form 738, executed under the National Prohibition Act and regulations made pursuant thereto, is a forfeiture bond enabling the United States to

recover the full amount named therein in the event of a breach of its condition, or whether such bond is an indemnity bond restricting recovery to the actual damages shown by the United States to have resulted to it from such breach.

## THE LEDERER CASE, NO. 120

### OPINION BELOW

The opinion of the District Court is reported in 4 F. (2d) 418.

### STATEMENT OF THE CASE

On February 17, 1920, Francis O'Kane, doing business as a wholesale bottler in Philadelphia, Pennsylvania, applied to Ephraim Lederer, at that time Collector of Internal Revenue and Federal Prohibition Director at Philadelphia, for a permit to sell distilled spirits and wines for other than beverage purposes. As required by regulations issued under authority of Section 6 of the National Prohibition Act, O'Kane filed with his application a bond on Internal Revenue Form No. 738 in the sum of $2,000, with the Maryland Casualty Company of Baltimore, Maryland, as surety, conditioned that he would "fully and faithfully comply with the requirements of the laws of the United States now or hereafter enacted, and regulations issued pursuant thereto respecting the sale or use of distilled spirits and wines for other than beverage purposes." Under date of March 17, 1920, the Prohibition Director issued to O'Kane a permit authorizing and permitting him to sell

intoxicating liquors for other than beverage purposes "to others holding permits which confer authority to purchase and use intoxicating liquors for nonbeverage purposes," and reciting that "This permit is granted under the conditions that the provisions of National Prohibition Act and Regulations issued thereunder will be strictly observed."

While in possession of the aforesaid permit O'Kane withdrew from bond three barrels of whiskey and, so he alleged, sold the same to the Jersey Pharmacy at Philadelphia. No record of these transactions was kept by him on Record 52, as required by Paragraph (e), Section 58 of Regulations 60. (Ed. February 1, 1920.) Investigation also disclosed that no such concern as the Jersey Pharmacy existed, or had obtained a permit to purchase intoxicating liquors as required by Section 6 of the National Prohibition Act.

In consequence of the above-described unlawful divergence of whiskey, the Collector of Internal Revenue assessed against O'Kane taxes and a penalty as follows: (a) A tax, as wholesale liquor dealer under Section 3244 R. S., of $33.44; (b) a penalty, under Section 3176 R. S., of 25% of the amount last mentioned, $8.33, and (c) a so-called "differential tax" of $4.20 per proof gallon on the 138.8 proof gallons contained in the three barrels of whiskey, assessed under Section 600a of the Revenue Act of 1918, $549.36, doubled under Sec-

tion 35, Title II, of the National Prohibition Act, $1,098.72, the total assessment amounting to $1,140.39. O'Kane paid the taxes and penalty under protest and filed a claim for refund. The claim was allowed by the Commissioner of Internal Revenue to the extent of the $1,098.72 differential tax, because of an opinion by the Attorney General, that this tax was assessable only against the distiller and then only where it appeared that he had knowledge that the spirits, withdrawn ostensibly for nonbeverage purposes, were to be diverted to beverage use. (32 Op. At. Gen. 522.) As to the remaining $41.76, assessed as tax under Section 3244 R. S. and penalty under Section 3176 R. S., O'Kane's claim was rejected by the Commissioner. No refund whatever was made, however, as the Commissioner asserted that, as O'Kane had breached the condition of his bond, he was indebted to the United States in the full penal sum thereof. Demand made by the Commissioner upon O'Kane, as principal, and upon the Maryland Casualty Company, as surety, for the payment of the $2,000 penal sum of the bond, with the understanding that credit would be allowed *pro tanto* for the $1,098.72 conceded to have been illegally collected, was refused.

O'Kane thereafter brought the present action in the District Court of the United States for the Eastern District of Pennsylvania to recover from Lederer the sum of $1,140.39, comprising the full

amount of the revenue taxes and penalty alleged by the plaintiff to have been unlawfully assessed. Contesting said action Lederer filed an affidavit of defense in which he conceded that the differential tax of $1,098.72 had been unlawfully assessed against the plaintiff, but set up in counterclaim that there was due and payable to the United States from the plaintiff the sum of $2,000 because of the breach by the plaintiff of the condition of the aforesaid bond. On motion, the court issued a rule to show cause why judgment should not be given for the plaintiff for want of a sufficient affidavit of defense, said motion being in the nature of a demurrer under the Pennsylvania practice. At the hearing on the rule, Lederer contended that the bond in question was a forfeiture bond and that upon the breach of its condition the plaintiff and his surety became liable for the full amount named therein. The plaintiff, on the other hand, insisted that the bond was a mere indemnity bond, and additionally urged that, as he was neither a manufacturer of intoxicating liquors nor a wholesale druggist, neither he nor his surety could be held under the bond, because the permit for the granting of which the bond was given had issued contrary to law, it having been held by the Attorney General that permits of this sort could lawfully issue only to manufacturers and wholesale druggists. (32 Op. At. Gen. 392.)

Passing upon the foregoing contentions the District Court held that, when read in the light of the

regulations under which it was executed, the bond could not be construed as providing a fixed penalty for a violation of the permit and of Title II of the National Prohibition Act; that, on the contrary, the amount named in the bond represented the limit of the plaintiff's liability for damage resulting to the United States from a breach of the bond, and that as the affidavit of defense pointed out no standard or measure by which such liability could be determined, but relied upon the Government's counterclaim solely on the theory that the sum named in the bond represented a statutory penalty for violation of the National Prohibition Act and regulations issued thereunder, the affidavit did not set up a valid counterclaim. Because of this conclusion and of the fact that the plaintiff was not pressing his claim for the small amount of $41.67 which the defendant insisted had been lawfully assessed as tax and penalty, the court found it unnecessary to pass upon the plaintiff's further contention, that the bond was void because exacted as a condition precedent to the granting of a permit which had issued contrary to law. The court accordingly gave judgment for the plaintiff for the $1,098.72 conceded by the defendant to have been unlawfully assessed, with interest. (4 Fed. (2d) 418.) Upon writ of error sued out by Lederer, the Circuit Court of Appeals sent up its aforesaid certificate to this Court.

**EFFECT UPON THE LEDERER CASE CERTIFICATE OF THE DECISION OF THIS COURT IN SAGE v. UNITED STATES**

As the action brought by O'Kane was a personal one against Lederer, as former Collector, and not against the United States, the Government is in doubt, in view of the decision of this Court in *Sage* v. *United States*, 250 U. S. 33, whether Lederer had the right to set up as a counterclaim an obligation alleged to be due and payable to the United States. In the case cited a judgment recovered by Sage against a collector of internal revenue for part of a claim for a succession tax alleged to have been unlawfully assessed was paid by the United States. Sage thereafter brought an action in the Court of Claims against the United States to recover the balance of his claim. The Government demurred to the petition on the ground, among others, that the cause of action sued upon was *res judicata* in view of the previous judgment against the collector. The demurrer was sustained and the petition dismissed. Upon appeal, this Court held the aforesaid contention of the Government to be without merit, saying (pp. 36–38):

> The former judgment is not a bar. It is true that the statutes modify the common law liability for money wrongfully collected by duress so far as to require a preliminary appeal to the Commissioner of Internal Revenue before bringing a suit. Rev. Stats., Sec. 3226. It is true also that it is the duty

of the District Attorney to appear for the collector in such suits, Rev. Stats., Sec. 771; that the judgment is to be paid by the United States and the collector is exempted from execution if a certificate is granted by the court that there was probable cause for his act, Rev. Stats., Sec. 989; and that there was a permanent appropriation for the refunding of taxes illegally collected. Rev. Stats., Sec. 3689 (17). No doubt too, if it appeared in a suit against a collector who had acted with probable cause and had turned over his money to the United States, that a part of the tax properly was due to the United States, unnecessary formalities might be omitted and the sum properly due might be retained. Of course, the United States in such a case could not require a second payment of that sum. *Crocker* v. *Malley*, 249 U. S. 223. But no one could contend that technically a judgment of a District Court in a suit against a collector was a judgment against or in favor of the United States. It is hard to say that the United States is privy to such a judgment or that it would be bound by it if a suit were brought in the Court of Claims. The suit is personal and its incidents, such as the nature of the defenses open and the allowance of interest, are different. It does not concern property in which the United States asserts an interest on its own behalf or as trustee, as in *Minnesota* v. *Hitchcock*, 185 U. S. 373, 388. At the time the judgment is entered the United States is a

> stranger. Subsequently the discretionary action of officials may, or it may not, give the United States a practical interest in the amount of the judgment, as determining the amount of a claim against it, but the claim would arise from the subsequent official act, not from the judgment itself. *United States* v. *Frerichs,* 124 U. S. 315 * * *.

The foregoing language of this Court makes it plain that, in defending an action for the recovery of taxes alleged to have been illegally collected, a collector of internal revenue is not acting for or in behalf of the United States, but is seeking to prevent the entry of a personal judgment against himself. It would apparently follow that the collector is without right in such a case to set up as a counterclaim an alleged indebtedness of the plaintiff to the United States. As, therefore, in the instant case the certificate of the Circuit Court of Appeals shows that the bond questions arose out of Lederer's counterclaim that O'Kane was indebted to the United States, the questions certified are not in the *Lederer case* at all, and an answer given by this Court could not aid the Circuit Court of Appeals or affect the case, as the judgment of the District Court must be affirmed by the Circuit Court of Appeals without regard to the points presented in the certified questions. It would seem improper under the circumstances for this Court to answer the questions. *United States* v. *Buzzo,* 18 Wall. 125, 128–9; *United States* v. *Britton,* 108 U. S. 199, 207.

IF REQUIRING ANSWER, THE FIRST QUESTION CERTIFIED SHOULD BE ANSWERED IN THE AFFIRMATIVE AND THE SECOND IN THE NEGATIVE

If this Court should nevertheless be of opinion that the questions certified are properly in the case and require answer, the Government respectfully urges that the question, whether the bond is forfeitable upon breach of its condition in the full amount of its penal sum, should be answered in the affirmative, and that the question, whether recovery upon breach of the condition of such bond is limited to the actual damages sustained by the United States, should be answered in the negative. As establishing the correctness of these answers the Government begs leave to refer to and adopt its argument in the *Zerbey case*, where the questions certified are precisely the same and are unmistakably involved, and where the bond was executed upon the same form and under the same law and regulations as in the *Lederer case*.

## THE ZERBEY CASE, NO. 790

### OPINION BELOW

The opinion of the District Court has not been officially reported. It is quoted in full, however, in the appendix to this brief.

### STATEMENT OF THE CASE

In the *Zerbey case* the United States filed its statement of claim in the District Court of the United States for the Middle District of Pennsylvania against John E. Zerbey and the National Surety Company, his surety, to recover the full

amount named in a Form 738 permit bond executed by Zerbey and the condition of which it was alleged he had breached. The District Court sustained a demurrer to the statement of claim, holding that the bond sued upon was not a forfeiture bond but a mere indemnity bond, and that, as under the pleadings no pecuniary loss or damage was alleged to have been suffered by reason of the alleged breach, the action could not be maintained. The statement of claim was accordingly dismissed and the United States took the case on writ error to the Circuit Court of Appeals, which has certified to this Court the following questions:

> 1. Is a bond conditioned upon compliance with the law of the United States and regulations issued pursuant thereto, respecting the sale or use of distilled spirits and wines for other than beverage purposes, given the United States by one to whom a permit to sell intoxicating liquors for other than beverage purposes has been issued under the provisions of Section 6 of Title II of the National Prohibition Act and regulations promulgated thereunder, forfeitable upon breach of the condition in the full amount of its penal sum?
>
> 2. Is recovery upon breach of the condition of such a bond given by one holding such a permit limited to actual damages sustained by the United States?

#### STATEMENT OF FACTS

On January 23, 1920, John E. Zerbey applied for a permit "to sell distilled spirits and wines for

other than beverage purposes to others holding like permits," and filed with his application a bond for $100,000, bearing the same date, upon which the National Surety Company appeared as surety. The bond was executed on Form 738, prescribed by Treasury Decision 2940, and was conditioned that the principal should "fully and faithfully comply with all the requirements of the laws of the United States now or hereafter enacted and regulations issued pursuant thereto, respecting the sale or use of distilled spirits and wines, for other than beverage purposes."

On January 26, 1920, the Federal Prohibition Commissioner, acting under and by virtue of the authority of the Commissioner of Internal Revenue, issued to Zerbey a permit reciting:

> Application having been duly presented and approved, you are hereby authorized and permitted to sell intoxicating liquors for other than beverage purposes, to wit: To others holding permits which confer authority to purchase and use intoxicating liquors for nonbeverage purposes.
>
> * * * * *
>
> This permit is granted under the conditions that the provisions of National Prohibition Act and Regulations issued thereunder will be strictly observed.

With the foregoing permit in hand and unrevoked, Zerbey, between March 6, 1920, and July 30, 1920, (1) failed to keep records of sales made by him of distilled spirits as required by the National Prohibition Act and regulations made pursuant

thereto; (2) sold and disposed of a large quantity of distilled spirits for beverage purposes; (3) diverted a large quantity of distilled spirits to other than beverage purposes, and (4) had in his possession upon his premises about thirty-six barrels of whiskey which had been withdrawn for other than beverage purposes from a bonded warehouse subsequent to the effective date of the National Prohibition Act, of which distilled spirits no record was kept by him as required by the National Prohibition Act and regulations made pursuant thereto.

Notice of these breaches of the condition of the bond was given Zerbey and the National Surety Company and due demand was made upon them for payment of the amount of the bond. No part of the sum demanded having been paid, the United States brought the present action to recover the full penal sum of the bond on the ground that said sum had been forfeited by the defendant and was due and owing by them to the United States by reason of the aforesaid breaches of the condition of the bond.

To the plaintiff's statement of claim the defendants jointly and severally filed affidavits of defense raising questions of law, which under the Pennsylvania Practice Law constituted demurrers, wherein they asked the judgment of the court upon the following, among other, propositions of law:

> 1. Even if the bond given by the defendants has been breached, the Government is

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not merely by virtue of any breach entitled to recover the full amount of the bond, that full amount being but the penal sum and *the maximum limit of recovery;* all that the Government can recover is a sufficient amount to indemnify it for its actual financial loss, injury or damage suffered and incurred on account or by reason of such breach or breaches.

* * * * *

4. There can be no recovery in this suit on the bond sued on because it is not a forfeiture bond.

Sustaining the defendants' contentions, the District Court in a memorandum opinion held that the bond was an indemnity bond and that as no pecuniary loss or damage was alleged in the pleadings to have been suffered in consequence of the breaches charged, the action could not be maintained. It accordingly directed the entry of a judgment dismissing the action. To review that judgment the United States sued out a writ of error from the Circuit Court of Appeals and that court has sent up its aforesaid certificate to this Court.

## SUMMARY OF THE ARGUMENT

The bond sued upon, as evidenced by its plain recitals, as well as by the statute which authorized it, the regulations under which it was prescribed, and the administrative construction of its purpose and effect, is a bond required by the Government of the principal named therein, not to secure the

United States against any supposed pecuniary damage it might sustain from a breach, but to insure the observance by the principal of the law and regulations in pursuance of which the bond was given.

Sec. 6, Title II, National Prohibition Act.
Treasury Decision 2940, Article 15 (b), (f).
Regulations 60 (Ed. Feb. 1, 1920), Sec. 20 (a), (c).
Treasury Decision 2559, p. 12.
Treasury Decision 2788, p. 23.
32 Op. At. Gen. 365, 366.

Upon a breach of the condition of such a bond the full penal sum is recoverable as a penalty or forfeiture against which neither a court of equity nor a court of law will relieve, first, because it is imposed by law, and second, because no adequate compensation can be adjudged for the affront to the sovereignty and the injury to the public welfare resulting from the breach.

*Clark* v. *Barnard*, 108 U. S. 436, 455–456, 459.
*United States* v. *Dieckerhoff*, 202 U. S. 302, 312.
*United States* v. *Montell*, 26 Fed. Cas. 15798.
*The Oteri*, 67 Fed. 146.
*Illinois Surety Co.* v. *United States*, 229 Fed. 527, 530.
*United States* v. *Rubin*, 233 Fed. 125.
*United States* v. *Engelberg*, 2 F. (2d) 720.

*Lyman* v. *Perlmutter,* 166 N. Y. 410, 413–414.

*Lightner* v. *Commonwealth,* 31 Pa. 341.

*Paducah* v. *Jones,* 126 Ky. 809, 824.

*Sedgwick on Damages* (9th Ed.), Vol. 1, Sec. 416–a.

*Sutherland on Damages* (3rd Ed.), Vol. 1, Sec. 279.

*Klein* v. *Insurance Co.,* 104 U. S. 88, 90.

*Peirce* v. *New York Dock Co.,* 265 Fed. 148, 156.

*Gates* v. *Parmly,* 93 Wis. 294, 307.

*Grigg* v. *Landis,* 21 N. J. Eq. 494, 502.

*Thompson* v. *Whipple,* 5 R. I. 144, 148.

*Hagar* v. *Buck,* 44 Vt. 285, 291.

*Pomeroy Eq. Jur.,* Vol. 1, Sec. 381.

*Story Eq. Jur.* (14 Ed.), Sec. 1726.

*Sedgwick on Damages* (8th Ed.), Vol. 1, Sec. 391.

Recovery may be had upon such a bond notwithstanding that it contains covenants in excess of those authorized by the statute. If the breach is of a covenant within the authority of the statute the bond will be held to be a valid statutory bond to that extent and the excess rejected as surplusage. If the covenant breached is not within the statutory authority, the bond, having been entered into by competent parties and not being prohibited by law or opposed to public policy, will be held to be a valid and binding obligation at common law. Moreover, the obligor, having enjoyed the benefits for which the bond was given, is estopped to deny its validity.

*Speake* v. *United States*, 9 Cranch 27, 35.

*United States* v. *Tingey*, 5 Pet. 114, 127.

*United States* v. *Bradley*, 10 Pet. 343, 359–360.

*United States* v. *Linn*, 15 Pet. 290, 315–316.

*United States* v. *Hodson*, 10 Wall. 395, 406–409.

*Jessup* v. *United States*, 106 U. S. 147.

*Moses* v. *United States*, 166 U. S. 571, 586–587.

*United States* v. *Dieckerhoff*, 202 U. S. 302, 309.

While penalties and forfeitures are not favored in the law and the court will seek diligently for a ground upon which to hold that they have not been incurred, nevertheless, if actually incurred, they will be enforced in a court of law.

*New York Life Ins. Co.* v. *Statham*, 93 U. S. 24, 31.

*Insurance Co.* v. *Norton*, 96 U. S. 234, 242.

*Klein* v. *Insurance Co.*, 104 U. S. 88, 90.

*Thompson* v. *Insurance Co.*, 104 U. S. 252, 258.

*Iowa Life Ins. Co.* v. *Lewis*, 187 U. S. 335, 350.

## ARGUMENT

### I

### THE APPLICABLE LAW AND REGULATIONS

By Section 6, Title II, of the National Prohibition Act, it is provided:

> No one shall manufacture, sell, purchase, transport, or prescribe any liquor without

first obtaining a permit from the Commissioner so to do. * * *

* * * * *

The Commissioner may prescribe the form of all permits and applications and the facts to be set forth therein. Before any permit is granted the Commissioner may require a bond in such form and amount as he may prescribe to insure compliance with the terms of the permit and the provisions of this title. * * *

Treasury Decision 2940, promulgated to carry the foregoing and other statutory provisions into effect, provided in Article 15:

> (b) The applicant, before or at the time of filing application for permit, is required to furnish a bond, in duplicate, conditioned that he shall fully and faithfully comply with the laws of the United States now or hereafter enacted, and all regulations issued pursuant thereto, respecting the sale or use of distilled spirits or wines for other than beverage purposes.

In accordance with this regulation the bond executed by Zerbey was conditioned as follows:

> Now, therefore, the condition of this obligation is such that if the said principal shall fully and faithfully comply with the requirements of the laws of the United States now or hereafter enacted and regulations issued pursuant thereto, respecting the sale or use of distilled spirits and wines for

other than beverage purposes, then this obligation to be void; otherwise to remain in full force and virtue.

The amount named in the bond was determined pursuant to paragraph (f), Article 15 of Treasury Decision 2940, amended by Treasury Decision 2946 to read as follows:

> (f) The basis of the penal sum of the bond, Form 738 or 738A, covering the use or sale of nonbeverage spirits, is $4.20 per proof gallon, on the quantity of spirits which will be received during any quarterly period of the calendar year, plus the amount of nonbeverage spirits on hand at the end of the preceding quarter.
>
> The penal sum of bonds covering wines will be computed at the rate of $100 for each 200 gallons, or any fractional part thereof, which will be received during any quarterly period of the calendar year, plus the amount on hand at the end of the preceding quarter.
>
> The penal sum of a bond to cover both nonbeverage spirits and wines shall be the aggregate sum of the amount required for each. Provided, however, that the penal sum of any bond shall not be less than $1,000 nor more than $100,000.

Prior to the filing by Zerbey of the aforesaid bond the Commissioner of Internal Revenue prescribed Regulations 60. (Ed. of Feb. 1st, 1920.) These regulations were approved by the Secretary of the Treasury under date of January 16, 1920,

and required in Section 20 thereof that persons desiring to obtain permits should file a bond on Form 1408 or Form 1409 "to insure compliance with the provisions of this act and of these regulations as well as to cover any taxes and penalties which may be imposed under the Internal Revenue Laws." Form 1408 was a new form of bond designed to supersede the old bond on Form 738, and Form 1409 was a new form, with collateral security instead of corporate or individual surety, prescribed to replace the old collateral bond on Form 738A. Paragraph (a) of Section 20 fixed the penal sum of bonds on Forms 1408 and 1409 at the same rates per gallon for distilled spirits and wines as did Treasury Decisions 2940 and 2946 for bonds on Forms 738 and 738A, and paragraph (c) provided:

> Where holders of permits to use or sell nonbeverage spirits or wines have given bond as provided in Treasury Decision 2940 and Treasury Decision 2946, and such bonds are in sufficient penal sum, no new bonds need be furnished until such persons are called upon by the directors to make applications for new permits, as provided in section 17, when they will be required to file new bonds on Form 1408 or Form 1409.

As the penal sum prescribed by Treasury Decisions 2940 and 2946 for bonds covering the sale or use of distilled spirits or wines was the same as that required by Regulations 60, the bond given by Zerbey on Form 738 was sufficient, under para-

graph (c), so long as the Prohibition Director did not require him to apply for a new permit. No such requirement was made by the Prohibition Director, and Zerbey's bond on Form 738 was accordingly a valid and subsisting obligation during the period of the aforesaid breaches of its condition.

It is therefore the Government's contention that the liability upon the bond in suit is to be determined according to the legal effect of the covenants contained therein, read in the light of the foregoing law and regulations under which that bond was executed and delivered, and that that liability is not altered by the fact that other bonds which Zerbey might have been permitted or required to give contained covenants differing in phraseology and possibly in legal effect.

## II

### BONDS TO SECURE PERFORMANCE OF A PUBLIC DUTY OR OBLIGATION

It may be conceded that there is authority for the general proposition that where a contract entered into between private individuals for the promotion of a private enterprise stipulates that one of the parties shall forfeit and pay to the other a stated sum in the event of a breach of the contract, the court will not enforce the forfeiture unless it appears that the sum stipulated represents the *bona fide* estimate or liquidation by the parties of the

damages which will be suffered by the obligee in consequence of such breach in a case where the damages are of an uncertain nature, but will allow recovery only of such part of the sum named as will reimburse the obligee for the actual damages sustained by him.

It is equally well settled, however, that where the parties to the contract are the Government, a State, city, or other political subdivision on the one hand, and an individual on the other, and the sum stipulated in the contract is to insure performance by said individual of a statutory or public duty or obligation, rather than to secure the obligee against an actual ascertainable loss, the full amount named in the contract is forfeited upon a breach by the obligor. The rule is thus stated in *Sedgwick on Damages* (9th Ed.), Vol. 1, Sec. 416-a:

> In the case of a bond in a penal sum given to the State or to a city, not to secure it against actual ascertainable loss but in order to secure performance by means of a forfeit of a contract entered into for the public benefit, the recovery is for the full amount of the penalty; for the damages would usually be difficult or impossible of ascertainment, and the intention of the parties is held to be that an absolute forfeiture is contemplated.

The leading case upon the subject is *Clark* v. *Barnard,* 108 U. S. 436, in which a bond for $100,000 given to the State of Rhode Island to se-

cure the completion of a railroad extension by a given date was declared forfeited in the full amount by reason of the obligor's default, although no pecuniary damages were shown to have been suffered by the State. In the course of the well-reasoned opinion handed down by Justice Matthews in that case, it was said (p. 459):

> Recurring now to the particular circumstances of the present case, with a view to the application of these principles and decisions, we are satisfied that the proper solution of the question now under examination is to be found in two principal considerations.
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> The first of these is, that it was not intended by the parties, the State of Rhode Island on the one hand, and the Boston, Hartford & Erie Railroad Company on the other, that the obligation given and accepted should be for an indemnity against any loss or damage expected to be suffered by the State, in the event that the railroad company should fail to build the railroad as required. It is found as a fact that no such loss or damage has in fact ensued. It is equally plain that none could possibly have arisen. The security is not to be extended to any supposed damage to private interests legally affected by the process of constructing the work. All damage of this kind to private persons was carefully provided for in other parts of the act. As to the State itself, the real party to the arrangement and contract,

> it could gain nothing in its political and sovereign character by the construction of the road, it could lose nothing by the default. If it could be supposed as possible that the State had in view the public interests of commerce and trade in the construction of the proposed railroad, and meant to provide for loss and damage to them by reason of its failure, the obvious answer is that no computation and assessment of actual damages on that account would be practicable, leaving as the alternative that the State, in fixing the penalty of the bond in the statute, had established its own measure of the public loss. The question of damages and compensation was not, because it could not have been, in contemplation of the parties.
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> In the second place, we think that the sum named in the statute is imposed by it as a statutory penalty for the nonperformance of a statutory duty. The obligation required is that the railroad company shall give a bond, with satisfactory security, that they will obey the law, that they will complete their road as required by it. The language evidently means that, in case they fail to do so, they shall forfeit and pay the sum named; and in order to insure its payment, additional parties to the bond, as sureties, are required.

Another case often cited upon this point is *United States* v. *Montell,* 26 Fed. Cases 15798, decided by Chief Justice Taney on circuit. That

case involved a bond given pursuant to the Act of 1792, which provided that, previous to the registry of any vessel, the owner and master, together with one or more sureties, should become bound to the United States for the performance of specified requirements regarding the vessel, among them, that the registry should be returned in certain contingencies. The Act further provided that the amount of the bond should be graduated according to the size of the vessel, and, by reference to an earlier statute, that one-half of all penalties, fines, and forfeitures incurred under the Act should be equally divided among the collector of customs, the naval officer, and the surveyor.

There being default in the return of the registry, the United States brought suit on the bond and recovered a judgment for the full amount thereof. The collector thereupon filed in the court a petition, asserting that the amount recovered was a penalty incurred under the Act and praying that a moiety thereof be paid to him and to the other two officers. Being of the view that the amount of the bond was not such a penalty, the District Court dismissed the petition, and the collector appealed to the Circuit Court. In the course of an opinion reversing the action of the District Court, Chief Justice Taney observed (p. 1294):

> Penalties and forfeitures imposed by statute are not usually provided for by bond and security given in advance. The sum recovered from Montell is recovered upon a

> contract; the action was brought upon a contract; and was not and could not have been brought in any of those forms which are usually necessary for the recovery of fines or forfeitures imposed by law. Yet this sum was, in truth, forfeited by Montell, by reason of his violation of a duty imposed by the act of Congress; it was a specific penalty upon the owner and master, for the commission of a particular offense against the policy of that law. And although the amount was secured by bond given for the performance of the duty, yet this duty was a part of the same policy with other duties mentioned in the act, and for which other penalties are inflicted; a moiety of which last-mentioned penalties, it is admitted, go to the collector, naval officer and surveyor.

Referring further to the character of the bond, the Chief Justice said (p. 1295):

> It certainly is not to be regarded as a bond with a collateral condition, in which the jury are to assess the damages which the United States shall prove that they have sustained; for, according to that construction, the amount of damages would not depend upon the amount of the penalty prescribed in the section, which is graduated according to the size of the vessel, but would depend upon the discretion of different juries, and larger damages might be given where the penalty was only four hundred dollars, than in a case where the penalty was two thousand. This, obviously, is not the

intention of the law; and the United States are entitled to recover the whole sum, for which the party is bound if any one of the conditions are broken. Besides, how could the United States prove any particular amount of damages to have been sustained by them in a suit on this bond? What do they lose? It would be difficult, I think, by any course of proof, or any process of reasoning, to show that the United States had sustained any particular amount of damages in a case of this description, or to adopt any rule by which the damages could be measured by a jury, or be liquidated by agreement between the parties.

The sum, for which the parties are to become bound, is manifestly a penalty or forfeiture, inflicted by the sovereign power for a breach of its laws. It is not a liquidated amount of damages due upon a contract, but a fixed and certain punishment for an offense. And it is not the less a penalty and a punishment, because security is taken before the offence is committed, in order to secure the payment of the fine if the law should be violated.

In *Illinois Surety Co.* v. *United States*, 229 Fed. 527, a bond given to the United States to secure the entry into this country of four alien children was conditioned that the children should attend school until sixteen years of age; that until that time none of them should perform any work which would interfere with their regular attendance at school; that

written reports should be sent every three months to the Commissioner of Immigration as to their school attendance and the work, if any, performed by them, and that none of the children should become a public charge. When sued upon this bond, the obligor contended, among other things, that the United States could not recover because it could not show that it had suffered any pecuniary loss in consequence of the breach. Neither the District Court nor the Circuit Court of Appeals for the Second Circuit found any merit in this contention, however. The latter court, in an opinion affirming the judgment recovered by the United States for the full amount of the bond, declared (pp. 530–1):

> This court cannot look into the record to discover whether there is proof that the plaintiff suffered any damages because of any omission on the part of defendant to perform the obligation imposed by the bond. But if we were at liberty to do so, and should find a total absence of proof that the United States had suffered any damages, it could not defeat the action or afford any reason for the dismissal of the complaint. If this bond had been given to an individual, instead of to the government, it might be important that it contained no less than 16 conditions of varying importance; for courts have held that where an agreement contains several distinct and independent covenants, upon which there may be several breaches, and one sum is stated to be paid upon the breach of performance, that sum is to be re-

garded as a penalty, and not liquidated damages. *Lampman* v. *Cochran*, 16 N. Y. 275; *Hoagland* v. *Segur*, 38 N. J. Law, 230; *Chase* v. *Allen*, 13 Gray (79 Mass.) 42; *Keck* v. *Bieber*, 148 Pa. 645, 24 Atl. 170, 33 Am. St. Rep. 846. That doctrine was applied by the Supreme Court in *Bignall* v. *Gould*, 119 U. S. 495, 7 Sup. Ct. 294, 30 L. Ed. 491 (1886). *But in the case at bar, as the bond was given to the government, it would not be in the least material whether the bond contained 16 conditions or only 1.*

The general rule is that in case of a penalty the measure of damages is the actual loss which has been sustained as a result of the breach where this can be ascertained. But in the case of liquidated damages there can be a recovery of the whole amount where such a recovery is consistent with the policy of the law. And generally the courts construe the sum mentioned in a bond as a penalty, considering it merely as a security for the damage actually sustained by the breach of the condition and they limit the recovery to an amount compensatory therefor. But while the above doctrine is that which courts usually enforce they do not apply it in all cases. *And they do not apply it in the case of bonds running to the government.* (Italics supplied.)

In *United States* v. *Dieckerhoff*, 202 U. S. 302, the bond was conditioned upon a return to a collector of customs, upon demand, of certain goods released to an importer pending determination of the

duties payable thereon. The obligor failed to return the goods when requested by the Collector and, when sued by the United States upon the bond, contended that the plaintiff could recover only the actual damages it had sustained by reason of the breach, that is, the amount of the duties payable on the goods. This Court held, however, that the bond was designed to secure the return of the goods and not merely to insure payment of the duties It, therefore affirmed the judgment in favor of the United States for double the value of the goods, as specified in the bond, saying (p. 312): "In such cases the recovery is for the stipulated sum, and is not limited to the damages actually proven. *Clark* v. *Barnard*, 108 U. S. 436, 457."

The same rule was held to govern by the Court of Appeals of New York in *Lyman* v. *Perlmutter*, 166 N. Y. 410. In that case the bond given by Perlmutter at the time he applied for a liquor tax certificate was conditioned that he would not permit gambling on the premises described in the certificate, or allow said premises to become disorderly, or violate any of the provisions of the Liquor Tax Law or any act amendatory thereof or supplemental thereto. Subsequent to the issuance to him of the certificate, Perlmutter violated the last mentioned condition of his bond by selling liquor on the premises on a Sunday. Suit to recover the full penal sum of the bond was thereupon brought by Lyman, as State Excise Commissioner, and resulted in a judgment for the plaintiff which was

affirmed by the Appellate Division. Upon further appeal to the Court of Appeals, Perlmutter contended that the bond was given solely as collateral security for the payment of fines and penalties, and that recovery upon it was to be limited accordingly. Rejecting this view, however, the Court of Appeals said (pp. 413-414):

> In cases between the government and a private party, in which the purpose of the bond is to secure an observance of the law in pursuance of which the bond is given, and punishment or satisfaction for its non-observance, then the penalty named in the bond is the measure of damages for its breach, unless the statute under which the bond is given or the bond itself, read in the light of the statute, indicates a less or different measure. * * * Where the breach of the condition is an offense against public law or policy, pecuniary damages, if they follow, are usually a minor incident; the affront is to the state and its sovereign will; but some sort of satisfaction should be exacted, and when the statute has fixed its measure in money, the courts must award it. (*Story Eq.* sec. 1326; 4 *Am. & Eng. Ency. of Law* (2d ed.), 700; *Clark* v. *Barnard*, 108 U. S. 436, and cases cited.)

Decisions similar to the foregoing were rendered in:

*The Oteri*, 67 Fed. 146.

*United States* v. *Rubin*, 233 Fed. 125.

*United States* v. *Engelberg*, 2 Fed. (2d) 720.

*United States* v. *Hatch,* 26 Fed. Cas. 15,325.

*United States* v. *Pingree,* 27 Fed. Cas. 16,050.

*Lightner* v. *Commonwealth,* 31 Pa. 341.

*Paducah* v. *Jones,* 126 Ky. 809, 824.

*Quintard* v. *Corcoran,* 50 Conn. 34, 39–40.

*Salem* v. *Anson,* 40 Ore. 339, 346.

*Nilson* v. *Jonesboro,* 57 Ark. 168, 177.

*Benson* v. *Gibson,* 3 Atk. 395, 396.

*Treasurer* v. *Patten,* 1 Root (Conn.) 260.

*State* v. *Hall,* 70 Miss. 678, 682.

*City of Albany* v. *Cassel,* 11 Ga. App. 745, 749.

*State* v. *Corron,* 73 N. H. 434, 454.

See also, 9 *Corpus Juris* 130.

*Sutherland on Damages* (3rd Ed.) Vol. 1, Sec. 279.

The principal affirmed by the authorities cited is controlling in the case at bar. Here, as evidenced by its condition, the bond given the United States by Zerbey was to insure the performance by him a public duty or obligation; that is, his full and faithful compliance with the laws and regulations respecting the sale or use of distilled spirits and wines for other than beverage purposes. A violation of such laws or regulations on his part, with the consequent breach of the condition of his bond, would constitute an affront to the dignity of the sovereignty and an injury to the public welfare as incapable of admeasurement in dollars and cents as was the failure to return the

ship's registry in the *Montell* case, or the failure of the alien children to attend school in the *Illinois Surety Company* case, or the failure to complete the railroad extension by a specified date in *Clark* v. *Barnard*. The authority conferred by the statute, to require a bond "to insure compliance with the terms of the permit and the provisions of this title," manifestly granted no power to require a bond to secure the United States against financial loss, and the language of the bond will be examined in vain for any indication of an attempt to exercise any such right. On the contrary, the purpose of the bond, as its plain and unambiguous stipulations clearly show, was to insure compliance with the laws and regulations which the issuance to the principal of a permit to sell intoxicating liquors afforded an enlarged opportunity to violate, by providing a penalty to be imposed in the event of such violation. As said by Chief Justice Taney of the liability upon the bond in the *Montell* case, *supra*, the sum for which Zerbey and his surety became bound "is manifestly a penalty or forfeiture, inflicted by the sovereign power for a breach of its laws. It is not a liquidated amount of damages due upon a contract, but a fixed and certain punishment for an offense. And it is not the less a penalty and a punishment, because security is taken before the offense is committed, in order to secure the payment of the fine if the law should be violated." (P. 1295.)

## III

### ADMINISTRATIVE CONSTRUCTION

The form of bond here involved was originally prescribed by Treasury Decision 2559, promulgated in connection with the enforcement of Sections 15 and 16 of the Food Control Act of August 10, 1917. That Decision provided (p. 12) that:

> Any violation of these regulations will subject the offender to the penalty provided by the statute (Act of August 10, 1917), to wit, a fine not exceeding $5,000, or imprisonment for not more than two years, or both, and to the pains and penalties denounced by statute for violation of the internal revenue laws, *as well as to liability on his bond.* (Italics ours.)

Bond Form 738 was repeated in Treasury Decision 2788, prescribed to carry out the provisions of the Food Control Act of 1917, the War Prohibition Act of 1918, and the Revenue Act of 1918. The distinctive liability upon the bond was reiterated in that decision in the following language (p. 23):

> Any person who violates these regulations is subject to the penalties provided by (1) the act of August 10, 1917; (2) the act of November 21, 1918; and (3) the revenue act of 1918, *as well as to liability on his bond.* (Italics ours.)

The subsequent passage of the National Prohibition Act made a change in the regulations neces-

sary. Treasury Decision 2940 was accordingly promulgated for the enforcement of that Act as well as of the three prior Acts. It adopted Form 738 as the bond to be used and expressly declared that Treasury Decision 2788 was continued in force except as modified by Treasury Decision 2940. No modification was made, however, of the above-quoted provision of Section 2788 defining the liability on the bond.

It thus appears that from the time the form of bond in suit was originally adopted the Executive Department of the Government charged with the administration of the laws under which it was given has consistently held it to be forfeitable in its full amount for a breach, without regard to the pains and penalties to which the obligor would also be liable in consequence of the violation of law which would necessarily accompany such breach. This was the effect given the bond by the Attorney General in an opinion rendered to the Secretary of the Treasury in 1920. (32 Op. At. Gen. 365.) It likewise conformed to the purpose for which the bond is authorized by the statute, which is, not to secure the Government against mere pecuniary loss, but " to insure compliance with the terms of the permit and the provisions of this title."

In the face of these regulations having the force of law (*Ex parte Reed*, 100 U. S. 13, 22; *Boske* v. *Comingore*, 177 U. S. 459), there is no room for the claim that when entering into the contract evi-

denced by this bond the parties contemplated that the United States should recover only such damages as it could prove it had sustained from a breach.

Nor is the latter contention aided by any inference to be drawn from the manner in which the penal sum of the bond was required to be fixed by the regulations under which the bond was given. It is true that, so far as distilled spirits were concerned, the penal sum of the bond was required by Treasury Decision 2940, *supra,* to be in an amount which corresponded to the amount of taxes which would be due the United States if the obligor should divert to beverage purposes the spirits coming into his possession by virtue of his permit. As to wines, however, the penal sum of the bond differed materially from the tax. Some method of graduating the penal sum of the bond according to the amount of spirits and wines received by the permittee had to be devised, for it was obvious that the larger the amount of liquors received the greater would be the opportunity for unlawful diversions. That in the case of spirits, although not in that of wines, the Commissioner adopted, as a convenient and suitable basis for the penal sum of the bond, an amount approximating the tax per gallon payable on spirits received or disposed of for beverage purposes, no more indicates that the bond in this case was given to insure the payment of said tax than that the bond in the case of *The*

*Oteri*,[1] although in double the amount of the duties upon the goods there involved, was given to secure the payment of such duties. In the instant case the condition of the bond imposes no obligation upon the obligors to pay any taxes, penalties, or other moneys which might become due from them to the United States. It requires only that the principal on the bond shall comply with specified laws and regulations, and that must be presumed to have expressed the full intent of the parties. As stated by this Court in *United States* v. *Smith*, 8 Wall. 587, 590, where the Government sought to have a bond, given by a distiller of coal oil under the Revenue Act of June 30, 1864, declared to be subject to the same conditions as bonds required by that Act of distillers of spirits: "The bond has no reference to such conditions as are required in distillery bonds, and can not be affected by them. 'Tis not so written in the bond.'"

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[1] 67 Fed. 146. The bond in *The Oteri* case, as required by statute, was conditioned that certain goods should not be returned to the United States after their exportation and was in double the amount of the duties imposable upon such goods. In a suit by the United States for breach of the bond, the District Court held that the United States could recover only its actual loss, that is, the amount of the duties, and gave judgment for that amount only. The judgment was reversed by the Circuit Court of Appeals for the Fifth Circuit, which held that the bond was given, not to secure the United States for the payment of the duties, but to insure that the goods would not be returned to the United States, and that the full amount of the bond was, therefore, recoverable. See further reference to this case on page 45 of this brief.

## IV

### RELIEF AGAINST A FORFEITURE WILL NOT BE ADJUDGED UNLESS JUST COMPENSATION CAN BE AWARDED

Originally at common law the full amount named in a bond given to secure a collateral object was recoverable upon a breach of the condition, even though the condition was void in law or was impossible of performance at the time the obligation was entered into. *Co. Litt.* 206b; *Watts* v. *Camors,* 115 U. S. 353, 360. The same rule generally applied where performance, although possible at the time the instrument was executed, became subsequently impossible; the only exceptions being where such subsequent impossibility of performance was due to the act of God or of the law or of the obligee. *Taylor* v. *Taintor,* 16 Wall. 366; *Clark* v. *Barnard,* 108 U. S. 436, 454; *Sun Printing and Publishing Assn.* v. *Moore,* 183 U. S. 642, 655. The rigor of this early rule resulted in the statute of 8 and 9 William III, c. XI, Sec. 8, whereby actions for the recovery of penalties for breach of contract were placed on the same footing as actions to recover damages so far as the quantum of recovery was concerned.

Prior to that statute, however, equity had intervened to relieve the obligor from the apparent hardship of the common law rule. It did so on the theory that contracts were matters of specific performance and that a provision therein for a penalty did not alter their character. The result was that,

in equity, a contracting party would not be relieved against specific performance by paying the penalty, and, on the other hand, proceedings by the obligee to recover the penalty would be enjoined upon a subsequent performance of the contract itself, that is to say, in the case of a debt upon the payment of the principal, interest and costs, and in the case of any other contract upon reimbursement of the actual damages sustained. *Adams Treatise on Equity,* 8th Am. Ed. 107; *Clark* v. *Barnard, supra,* pp. 455-6. In accordance with the same principle, the rule came to be adopted that a court of equity would not interfere to relieve against a forfeiture for breach of covenants or conditions where just compensation could not be decreed. *Sedgwick on Damages* (8th Ed.), Vol. 1, Sec. 391; *Pomeroy Eq. Jur.,* Vol. 1, Sec. 381; *Story Eq. Jur.* (14th Ed., Sec. 1726). As stated by Justice Story in his work last mentioned:

> In short the general principle now adopted is that, wherever a penalty is inserted merely to secure the performance or enjoyment of a collateral object, the latter is considered as the principal intent of the instrument, and the penalty is deemed only as accessory, and, therefore, as intended only to secure the due performance thereof or the damage really incurred by the nonperformance. In every such case the true test generally, if not universally, by which to ascertain whether relief can or can not be had in equity, is to consider whether com-

pensation can be made or not. If it can not be made, then courts of equity will not interfere.

The doctrine has been recognized and upheld in a long line of cases:

*Farnsworth* v. *Minn. & Pac. R. R. Co.*, 92 U. S. 49, 68.
*Klein* v. *N. Y. Life Ins. Co.*, 104 U. S. 88, 90.
*Clark* v. *Barnard*, 108 U. S. 436, 455-6.
*Hackett* v. *Alcock*, 1 Call (Va.) 463, 466.
*Gates* v. *Parmly*, 93 Wis. 294, 307.
*Walker* v. *Wheeler*, 2 Conn. 299, 301.
*Jones* v. *Bennet*, 9 Dana 333.
*Grigg* v. *Landis*, 21 N. J. Eq. 494, 502.
*Thompson* v. *Whipple*, 5 R. I. 144, 148.
*Carpenter* v. *Westcott* 4 R. I. 225, 227–228.
*Hagar* v. *Buck*, 44 Vt. 285, 291.
*Donnelly* v. *Eastes*, 94 Wis. 390, 397.
*Peirce* v. *N. Y. Dock Co.*, 265 Fed. 148.

In the recent case last cited the Circuit Court of Appeals for the Second Circuit said (p. 156):

> The plaintiff, while insisting that no forfeiture was incurred, insists that, if the court is of a contrary opinion, the foreiture is one which a court of equity will relieve against. To relieve against a forfeiture, as has been said, is one of the oldest and best established functions of a court of equity. Story on Equity Jurisprudence, Sec. 1315. But equity, it is equally well known, does not relieve against all forfeitures, but only in a certain limited class of cases. *It is*

> *uniformly held that courts of equity do not interfere to relieve from forfeitures arising from breach of covenants and conditions, where there can not be any just compensation decreed for the breach.* As said by Lord Chancellor Macclesfield in *Peachy* v. *Duke of Somerset,* 1 Strange, 447, "It is the recompense that gives this court a handle to grant relief," * * *. (Italics ours.)

At law, the question of whether or not a forfeiture shall be adjudged arises most frequently, perhaps, in life insurance cases. The defense in such actions is almost invariably that the policy has been forfeited for failure to pay the premium on the day it became due. In *New York Life Insurance Co.* v. *Statham,* 93 U. S. 24, this Court, sustaining the contention of the insurance company that the policy had been forfeited for that reason, declared (p. 31):

> The case, therefore, is one in which time is material and of the essence of the contract. Nonpayment at the day involves absolute forfeiture, if such be the terms of the contract, as is the case here.

In *Insurance Co.* v. *Norton,* 96 U. S. 234, where a judgment for the plaintiff was affirmed on the ground that the insurance company had, by its conduct, waived the forfeiture clause of the policy, this Court said (p. 242):

> Forfeitures are not favored in the law. They are often the means of great oppres-

> sion and injustice. And, *where adequate compensation can be made,* the law in many cases, and equity in all cases, discharges the forfeiture, *upon such compensation being made.* (Italics ours.)

In *Klein* v. *Insurance Co.,* 104 U. S. 88, a bill in equity to enjoin the insurance company from taking advantage of an alleged forfeiture of the policy was dismissed by the Circuit Court on the merits. Upon appeal to this Court, the plaintiff conceded that forfeiture of the policy would be adjudged in an action at law, but contended that she was entitled to relief in equity by reason of certain excuses for nonpayment of premiums set out in her bill. This Court declared, however, (p. 90):

> We cannot accede to the view of the appellant. Where a penalty or a forfeiture is inserted in a contract merely to secure the performance or enjoyment of a collateral object, the latter is considered as the principal intent of the instrument, and the penalty is deemed only as accessory. *Sloman* v. *Walter,* 1 Bro. Ch. 418; *Sanders* v. *Pope,* 12 Ves. Jr. 282; *Davis* v. *West,* id. 475; *Skinner* v. *Dayton,* 2 Johns. (N. Y.) Ch. 526.
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> But in every such case the test by which to ascertain whether relief can or cannot be had in equity, is to consider whether compensation can or cannot be made.
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> If the payment of the premiums, and their payment on the day they fall due, are

> of the essence of the contract, so is the stipulation for the release of the company from liability in default of punctual payment. No compensation can be made a life insurance company for the general want of punctuality on the part of its patrons.

In *Thompson* v. *Insurance Co.*, 104 U. S. 252, the forfeiture of a policy of life insurance for failure to pay the premiums when due was sustained. After adverting in its opinion to the fact that the former view, that insurance companies could not do business without stringent provisions for a forfeiture, was being supplanted by a wiser policy which provided means of avoiding a forfeiture, this Court said (p. 258):

> The law, however, has not been changed, and if a forfeiture is provided for in case of nonpayment at the day, the courts can not grant relief against it. The insurer may waive it, or may by his conduct lose his right to enforce it; but that is all.

P. 260:

> Courts do not favor forfeitures, but they can not avoid enforcing them when the party by whose default they are incurred can not show some good and stable ground in the conduct of the other party, on which to base a reasonable excuse for the default.

See also, *Iowa Ins. Co.* v. *Lewis*, 187 U. S. 335, 350.

The authorities cited show clearly, it is submitted, that neither in equity nor at law will relief

be granted against a forfeiture unless adequate compensation can be adjudged, and that while forfeitures are not favored and the courts are diligent to find a ground upon which to hold that they have not been incurred, nevertheless, in a court of law, as distinguished from a court of equity, a forfeiture will be enforced where it has unquestionably been incurred.

It follows, therefore, that as no adequate compensation can be adjudged to the United States for the violation of its laws and regulations committed by Zerbey when admittedly he breached the condition of his bond, neither he nor his surety is entitled to relief from the resulting forfeiture of the penal sum of the bond.

## V

### FULL RECOVERY NOT PRECLUDED BY SECTION 961, REVISED STATUTES

Section 961 provides:

> In all suits brought to recover the forfeiture annexed to any articles of agreement, covenant, bond, or other specialty, where the forfeiture, breach, or non-performance appears by the default or confession of the defendant, or upon demurrer, the court shall render judgment for the plaintiff to recover so much as is due according to equity. And when the sum for which judgment should be rendered is uncertain, it shall, if either of the parties request it, be assessed by a jury.

The effect of the foregoing statute was considered in *United States* v. *Dieckerhoff*, heretofore cited. The bond in that case, given for the release of imported goods pending determination of the duties payable thereon, was construed by this Court as providing for a penalty for failure to return the goods upon demand of the collector, and as not intended merely to secure the United States for the payment of the duties. Answering a contention of the respondent that Section 961 prohibited the recovery of such penalty, this Court said (p. 312):

> It is further contended that Section 961, Rev. Stats., protects against enforcement of a penalty of this kind. This section provides [After quoting the statute the court proceeded]: But if we are correct in holding that it was the intention of Congress to provide a specific penalty for failing to return the merchandise as required, it is not within the province of courts of equity to mitigate the harshness of penalties or forfeitures in such cases, for such relief would run directly counter to the statutory requirements. *Story, Eq. Jur.* sec. 1326. We think the Circuit Court was right in rendering judgment for double the value of the unreturned package.

A similar contention made in the case of *The Oteri*, 67 Fed. 146, was similarly disposed of by the Circuit Court of Appeals for the Fifth Circuit. In that case the statute authorized a bond conditioned that goods should not be returned to the

United States after their exportation and furthermore provided that the penal sum of the bond should be in double the amount of the duties upon such goods. The United States having brought suit for the breach of a bond drawn under this statute, the District Court upheld the defendant's contention that only the actual loss sustained by the United States, viz, the amount of the duties imposable upon the returned goods, was recoverable, and gave judgment for the United States for that amount only. Upon appeal by the United States, the defendant contended, among other matters urged in support of the judgment, that it was required by Section 961 R. S. The Circuit Court of Appeals overruled the contention, however, saying (p. 151):

> The rule declared by this statute is to be generally applied in proper cases in the courts of the United States. If applied here, the question is, how much is due, according to equity, under the conceded breach of the bond? An examination of the bond shows that it is not a bond to secure the payment of any sum for duties or otherwise. * * * The bond is conditioned to secure the exportation of the merchandise in question beyond the United States, and its evident purpose, under the statute and the treasury regulations, is to prevent frauds upon the revenue. The admitted facts of this case show that the obligors did not export the merchandise beyond the United States, but permitted the same to be landed

> in the United States, and thereby a fraud on the government revenues resulted; * * *.
>
> If we are correct in treating the bond sued on as one in no respect given to secure the payment of duties or any other debt due the United States, but as a bond authorized and required by the statute and the treasury regulations for the purpose of preventing fraud on the revenues,—and we are unable to discover any other purpose for it,—we are of opinion that the said bond is not one in which equity, under the facts admitted, can relieve the obligors from payment of the full penalty stipulated. This conclusion is warranted by the opinion of the Supreme Court of the United States in *Clark* v. *Barnard,* 108 U. S. 436 et seq., 2 Sup. Ct. 878, in which the authorities are fully reviewed.

See also, *United States* v. *Alcorn,* 145 Fed. 995, 999.

It is plain from these cases that Section 961 cannot be relied upon to prevent full recovery of the penal sum of a bond such as that here in suit, both because the amount named in the bond is a penalty authorized by statute against which a court of equity will not relieve, and because no damages can, according to equity, be decreed for the breach.

## VI

### THE BOND IS VALID EITHER UNDER THE STATUTE OR AT COMMON LAW

The statute in the case at bar (Sec. 6, Title II, National Prohibition Act, supra) authorized a

bond "to insure compliance with the terms of the permit and the provisions of this title." The "terms of the permit" required that "the provisions of National Prohibition Act and regulations issued thereunder will be strictly observed." Under the statute, therefore, a bond was authorized to insure compliance with the provisions of the National Prohibition Act and the regulations issued thereunder. Moreover, a bond conditioned upon compliance with a statute covers any amendments to the statute enacted during the life of the bond (*United States* v. *Powell,* 14 Wall. 493, 501–2), and the same rule doubtless applies to subsequent amendments to regulations having the force of law.

The condition of Zerbey's bond is, however, that " said principal shall fully and faithfully comply with the requirements of the laws of the United States now or hereafter enacted and regulations issued pursuant thereto, respecting the sale or use of distilled spirits and wines for other than beverage purposes." As, at the time this bond was executed, there were statutes of the United States other than the National Prohibition Act respecting the sale or use of distilled spirits and wine for other than beverage purposes, it may be argued that the bond does not conform to the provisions of the statute authorizing it and that it is therefore void.

This Court has been called upon many times to pass upon such a contention respecting bonds given

the Government. It has invariably held that, notwithstanding that the bond has exceeded the requirements of the statute, if voluntarily given and neither prohibited by statute nor against the policy of the law it is a valid and subsisting obligation.

*Speake* v. *United States,* 9 Cranch 27, 35.

*United States* v. *Tingey,* 5 Pet. 114, 127.

*United States* v. *Bradley,* 10 Pet. 343, 359–360.

*United States* v. *Linn,* 15 Pet. 290, 315–316.

*United States* v. *Hodson,* 10 Wall. 395, 406–409.

*United States* v. *Mora,* 97 U. S. 413, 422.

*Daniels* v. *Tearney,* 102 U. S. 415, 420.

*Jessup* v. *United States,* 106 U. S. 147, 151, 152.

*United States* v. *Mynderse,* 154 U. S. 580.

*Moses* v. *United States,* 166 U. S. 571, 586–587.

*United States* v. *Dieckerhoff,* 202 U. S. 302, 309.

These decisions proceed upon one or the other of two principles: (1) That, without statutory authority, the United States, being a body politic, may enter into contracts which are within the sphere of its constitutional powers and are not prohibited by law, and (2) that if the breach is of a covenant within the authority of the statute, the bond will be held valid to that extent and the excess rejected as surplusage.

Both principles were reiterated in *United States* v. *Hodson, supra,* which was a suit by the United States to recover the full penal sum of a distiller's bond. In that case the Act specified that the bond should be conditioned that the principal would do or refrain from doing enumerated things commanded or prohibited by certain provisions of the Act. The bond was conditioned, however, upon compliance with *all* the provisions of the Act " and such other Acts as are now or may hereafter be in this behalf enacted." Upon the trial, the United States offered in evidence the bond and proof of its breach. Objection by the defendant to this evidence, on the ground that the bond was void because not in conformity with the statute, was sustained by the court and the evidence was excluded. Verdict and judgment went for the defendant and the United States brought the case to this Court upon writ of error. In the course of an opinion reversing the judgment and remanding the case for new trial, this Court said (p. 406):

> The record is silent as to any coercion or duress. The bond is, therefore, to be considered a voluntary one. *United States* v. *Bradley,* 10 Peters, 345. A bond in this form is not prohibited by the statute, nor is it contrary to public policy. It was founded upon a sufficient consideration, and was intended to subserve a lawful purpose.

After discussing its previous decisions in the *Tingey, Bradley,* and *Linn cases, supra,* and quoting as follows from the *Linn case:* " If this is a

contract, entered into by competent parties and for a lawful purpose, not prohibited by law, and is found upon a sufficient consideration, it is a valid contract at common law," the Court declared (p. 408):

> These cases are conclusive of the question before us. Their authority has not been shaken by any later adjudication; we think they rest upon the soundest principles, and are in accordance with a wise and salutary policy. We feel no disposition to reexamine the propositions they affirm.

The Court furthermore observed that, as the breaches relied upon by the United States were of requirements which the statute specified the bond should contain, the validity of the bond to that extent might also be sustained upon the narrower ground, that where a bond authorized by statute contains requirements in excess of those specified by the statute, the additional covenants, if severable, may be rejected and the bond held valid as to the statutory requirements. It concluded, however (p. 409):

> But we prefer to place our judgment upon the broader ground marked out by the adjudications of this court, to which we have referred. Every one is presumed to know the law. Ignorance standing alone can never be the basis of a legal right. If a bond is liable to the objection taken in this case and the parties are dissatisfied, the objection should be made when the bond is presented for execution. If executed

> under constraint, the constraint will destroy it. But where it is voluntarily entered into and the principal enjoys the benefits which it is intended to secure and a breach occurs, it is then too late to raise the question of its validity. The parties are estopped from availing themselves of such a defense. In such cases there is neither injustice nor hardship in holding that the contract as made is the measure of the rights of the government and of the liability of the obligors.

Although in the *Hodson case* the United States sued for the recovery of the full penal sum of the bond, no question appears to have been raised as to its right to a judgment for that amount if it could recover at all. In the *Dieckerhoff case,* however, this Court not only held that the bond was valid although not in conformity with the statute, but ruled that by reason of the failure to return the released goods upon demand, the full sum named in the bond (double the estimated value of the goods) was recoverable by the United States as "a specific penalty to be paid for failure so to do."

In the instant case, Zerbey breached his bond by failing to comply with provisions of the National Prohibition Act and regulations made pursuant thereto. The breaches were, therefore, of covenants which the statute authorized the bond to contain, and, in view of the foregoing decisions of this Court, the bond is to that extent valid under the

statute. But, even if the breaches were of covenants in excess of the statute, the bond would, under the same decisions, be a valid and enforceable obligation at common law. Moreover, having voluntarily entered into the bond and having enjoyed the benefits which it was given by him to secure, Zerbey is estopped, under the ruling in the *Hodson case, supra,* to deny its validity.

## VII

### DECISIONS CONTRA

In support of its judgment dismissing the action brought by the Government in the instant case, the District Court relied upon the decisions in *United States* v. *Wandmaker* (C. C. A., 8th Cir.), 292 Fed. 24; *O'Kane* v. *Lederer* (E. D. Pa.) 4 Fed. (2d) 418; *United States* v. *United States Fidelity & Guaranty Co.*, (W. D., N. Y.), 1 Fed. (2d) 335, and *United States* v. *National Surety Co.*, (Dist. of Idaho; unreported). For the convenience of the Court, the opinion in the unreported case last cited is set out in the appendix to this brief.

In the *Wandmaker case* the United States sued for the full sum of a bond on Form 738, as in the case at bar. The complaint was held bad on demurrer and the action dismissed. Upon appeal, the Circuit Court of Appeals affirmed the dismissal upon the grounds:

1. That the power conferred by the statute upon the Commissioner to prescribe the form of the bond required of a permittee vested in that officer

the right to prescribe the obligations of the bond and to name its condition, and that it was therefore competent for him to require a bond which would secure the United States for the payment of moneys which might become due to it by reason of a violation of the law or regulations by the permittee.

2. That as Wandmaker had the option of giving a bond on Form 738, with corporate or individual sureties, or a bond on Form 738A, with collateral security, the condition of the Form 738 bond actually executed by him was to be construed as having the same effect as the condition of a Form 738A bond, and as it was obvious that a Form 738A bond was intended only to secure the United States for the payment of taxes, interest, penalties, and other moneys which might become due to it by reason of a violation of law and regulations by the permittee, Wandmaker's liability on his Form 738 bond was similarly limited, and, there being no allegation that the obligors had failed to make such payments, the action had been properly dismissed.

3. That under the law and regulations Wandmaker, as permittee, had the right to manufacture medicinal compounds for other than beverage purposes and to use alcohol in their preparation, but was prohibited by law and regulations from making said compounds with an alcoholic content which would render them fit or usable for beverage purposes, and if so made from selling them; that it was to compliance with these laws and regulations

"respecting the sale or use of distilled spirits *for other than* beverage purposes" that Wandmaker was bound by the condition of his bond, not to compliance with laws and regulations respecting the sale or use of distilled spirits *for* beverage purposes; and therefore, as the only breach of condition alleged was that, having purchased alcohol for use in the manufacture of his medicinal preparations, he had sold such alcohol for beverage purposes, it was plain that no breach had occurred.

The question of whether the recovery upon Wandmaker's bond should be of the full penal sum thereof, or of only such unpaid taxes, interest, penalties, and other moneys as had become due from him to the United States by reason of his violation of the law and regulations, could properly arise for judicial decision only after a breach of condition had been shown. It is evident, therefore, that the third ground upon which the Circuit Court of Appeals based its decision really disposed of the whole case, for if there were no breach there could, of course, be no recovery whatever on the bond. The views expressed by the court as to *what* was recoverable in such case were, therefore, mere *dicta* lacking the force of authoritative decision.

Moreover, with all due deference to that learned court, we earnestly contend that the views expressed by it are erroneous. The fundamental error lay in its construing the authority to prescribe the *form* of the bond as an authority to pre-

scribe its *substance*. While leaving with the Commissioner the discretion to determine whether or not a bond should be required, and if required, authorizing him to prescribe its *form* and *amount*, the statute itself defined the *purposes* for which the bond was to be required, if at all, as "to insure compliance with the terms of the permit and of the provisions of this title." Congress certainly would not have thus defined the purposes for which the bond might be required if it intended that the Commissioner might nevertheless require a bond conditioned not only upon compliance with what the statute defined, but that the principal on said bond should pay all taxes, interest, penalties, and other moneys which might become due to the United States by reason of his violation of laws and regulations respecting the sale or use of distilled spirits and wines for other than beverage purposes. Had Congress intended to confer the latter authority it would have been a simple matter for it to have said so. That it did not so intend, is made plain by the authority which it did confer, viz., to fix the "form and amount" of the bond, coupled with its own direction as to what the bond should be required to insure.

In prescribing Form 738 no attempt was made by the Commissioner to secure the United States for the payment of any moneys whatsoever. Assuming, however, for the sake of the argument, that the Circuit Court of Appeals correctly held that

bond Form 738A was designed by the Commissioner with that object in view, and that as Wandmaker had the option to give a bond on either form, the Form 738 bond given by him was to be construed as having been required for the same purpose, it would follow that, so far as requirements of the bond exceeded the statutory authority, they would be invalid under the statute and might be rejected as surplusage and the covenants within the authority of the statute be held valid and enforceable. (See Point VI of this brief; *United States* v. *Bradley*, 10 Peters 343, 360–363; *United States* v. *Hodson*, 10 Wall. 395, 408–409; *Moses* v. *United States*, 166 U. S. 571, 590; *Ohio* v. *Findley*, 10 Ohio 51.) What the Commissioner intended, however, was material only in so far as it coincided with what Congress intended; and as the statute discloses no intent on the part of Congress to authorize a bond for mere purposes of indemnity, the bond in the *Wandmaker case* should have been construed, as its plain terms required, as intended to insure compliance with the specified laws and regulations, rather than to secure against financial loss.

It is furthermore to be noted that in the *Wandmaker* case the Circuit Court of Appeals made no attempt to find in the Form 738 bond given by Wandmaker any expression of a purpose to indemnify the United States against pecuniary damage. In reading into that bond a purpose gleaned from another form of bond which Wandmaker might

have given but did not, it is urged, the Circuit Court of Appeals committed error. It ruled, in effect, that the liability of a person for breach of a contract entered into by him is to be determined by the provisions of a contract into which he did not enter, solely because he had the option of entering into either. Such a theory, it is submitted, will not find support in any of the adjudicated principles of contract law.

The third ground upon which the Circuit Court of Appeals decided the *Wandmaker case*, viz, that it did not appear that Wandmaker had breached his bond because his sole obligations thereunder were that he would not use an excessive quantity of alcohol in his preparations, and that if he did he would not sell them, whereas the only breach alleged was that he had unlawfully sold for beverage purposes alcohol lawfully acquired by him for use in the manufacture of his compounds, is equally untenable. In the first place, the condition of the bond, that the principal would comply with the laws and regulations "respecting the sale or use of distilled spirits for other than beverage purposes," in no way limited the obligation to a compliance with any specific laws or regulations coming within the description mentioned. Compliance with all such laws and regulations was required, and Wandmaker would, for example, have breached his bond by failing to keep a record of his purchases of alcohol for legitimate use

(which record was required by Section 10 of the Act as well as by Section 58 of Regulations 60) as fully as by a sale of his compounds containing an excessive quantity of alcohol.

Furthermore, the court's ruling that a sale of distilled spirits *for* beverage purposes did not constitute a breach of the condition to comply with the laws and regulations "respecting the sale or use of distilled spirits *for other than* beverage purposes," would be correct only if there were no laws or regulations respecting the sale or use of distilled spirits *for other than* beverage purposes which prohibited the sale of distilled spirits *for* beverage purposes. Yet Section 4 of the National Prohibition Act does that very thing. By excluding them from the operation of the Act, it permits the manufacture and sale of denatured alcohol, medicinal preparations, patented medicines, toilet solutions, and flavoring extracts, notwithstanding that distilled spirits are among their ingredients, if they correspond to the descriptions and limitations mentioned in the section, that is to say, if they are unfit for beverage purposes. That section is, therefore, unmistakably a "law respecting the sale or use of distilled spirits *for other than* beverage purposes." Yet it contains the following provisions prohibiting the sale, *for* beverage purposes, of "liquor" (which term, as defined in Section 1, embraces all kinds of distilled spirits), as well as

59

of articles, containing distilled spirits, mentioned in the section:

> No such manufacturer shall sell, use, or dispose of any liquor otherwise than as an ingredient of the articles authorized to be manufactured therefrom.
>
> * * * * *
>
> Any person who shall knowingly sell any of the articles mentioned in paragraphs a, b, c, and d of this section for beverage purposes, * * * shall be subject to the penalties provided in section 29 of this Title.

The sale by Wandmaker of alcohol for beverage purposes certainly constituted a violation of the first of these quoted provisions, and consequently resulted in a breach of his bond. It is clear, therefore, that the ruling in the *Wandmaker case*, that the full penal sum of a Form 738 bond may not be recovered upon a breach of its condition, is not sustained by the reasoning upon which it is based.

The case of *O'Kane* v. *Lederer*, also relied upon by the District Court in the case at bar, is the District Court decision in the case certified to this Court by the Circuit Court of Appeals for the Third Circuit as *Lederer* v. *McGarvey, Executrix of the Estate of Francis O'Kane*. As appears from the statement of that case at the beginning of this brief, Lederer, being sued by O'Kane for the recovery of certain taxes and a penalty alleged to have been unlawfully assessed by Lederer as Collector of Internal Revenue, set up in counter-

claim that O'Kane was indebted to the United States in the full penal sum of a bond on Form 738, the condition of which he alleged O'Kane had breached. A demurrer by O'Kane to the counterclaim, on the grounds that a Form 738 bond was not a penal bond but a mere damage bond, and that no damages were alleged to have been suffered by the United States from the breach, was sustained. In passing upon the demurrer, Judge McKeehan treated the case as involving a bond executed under Section 20, Regulation 60, which required a bond on Form 1408 conditioned "to insure compliance with the provisions of this act and of these regulations as well as to cover any taxes and penalties which may be imposed under the internal-revenue laws." Observing that "If the regulations and the language of the bond had followed the provision of the Statute, I am inclined to think that the Government could recover the penal sum named in the bond," Judge McKeehan nevertheless declared that, when read in connection with the regulations under which it was executed, the bond was not limited in its requirements to a compliance with the terms of the permit and of Title II of the National Prohibition Act, as specified in the statute, but also required compliance with all laws thereafter enacted and regulations issued pursuant thereto respecting the sale and use of spirits and wines for other than beverage purposes, and was furthermore expressly declared to cover any

taxes and penalties which might be imposed under the internal-revenue laws. He concluded, therefore, that the amount named in the bond could not have been intended as a fixed penalty or punishment for a violation of the permit and of Title II, but must have been intended as fixing the limit of the damages which the United States could recover on the bond. (4 F. (2d) 418.)

As pointed out, however, in the discussion of Point I of this brief, bonds on Form 738 were not given in pursuance of the requirements of Section 20, Regulations 60, but were executed pursuant to Treasury Decisions 2940 and 2946, which did not require that they should cover any taxes, penalties, or any other payments which might become due to the United States. Judge McKeehan's ruling was, therefore, actually addressed to a bond on Form 1408, although no such bond was involved in the case before him. But even if O'Kane's bond were required by the regulations to contain, and actually did contain, the covenants referred to by Judge McKeehan, nevertheless, under the decisions of this Court heretofore cited, the bond would be valid under the statute to the extent that it conformed thereto, the remainder would be rejectable as surplusage, and the full penal sum would be recoverable for a breach of any covenant within the statute.

In each of the two remaining cases, *United States* v. *United States Fidelity & Guaranty Co.* and

*United States* v. *National Surety Company, supra,* the *Wandmaker* decision was cited and followed with little or no independent discussion. If, therefore, as the Government has endeavored to demonstrate, the decision in the *Wandmaker case* was erroneous, so also, it is urged, are the decisions in the two cases under discussion. But whether rightly or wrongly decided, those cases are not authority for a decision against the Government in the case at bar, for each involved a bond on Form 1408, which, as heretofore shown, is radically different in the scope of its condition from the bond on Form 738 here in suit.

Opposed to the foregoing decisions adverse to the Government are *United States* v. *Engelberg* (W. D. Pa.), 2 F. (2d) 720, and *United States* v. *Baumgartner* (Dist. of Md., unreported). In the first of these cases the United States sued to recover the full amounts named in two bonds, one on Form 738 and the other on Form 1408. A demurrer to the statement of claim, on the grounds that the bonds were damage bonds and that no damages were alleged, was overruled by Judge Thomson upon the authority of *Clark* v. *Barnard, United States* v. *Montell, Illinois Surety Co.* v. *United States,* and *Lyman* v. *Perlmutter,* discussed in Point II of this brief. In the *Baumgartner case* Judge Soper of the Maryland District overruled, without opinion, a demurrer interposed to the Government's bill of

complaint, in which full recovery was sought on a bond on Form 1408, and directed a verdict for the United States.

## CONCLUSION

It is respectfully submitted that the first question certified should be answered "Yes," and the second "No."

WILLIAM D. MITCHELL,
*Solicitor General.*
MABEL WALKER WILLEBRANDT,
*Assistant Attorney General.*
JOHN J. BYRNE,
*Attorney.*

FEBRUARY, 1926.

# APPENDIX

IN THE DISTRICT COURT OF THE UNITED STATES IN AND FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

United States of America, plaintiff, vs. John E. Zerbey and National Surety Company, defendants. No. 1496, January Term, 1923. On affidavit of defense raising questions of law

Andrew B. Dunsmore, Esq., United States attorney, Wellsboro, Penna., Hon. A. A. Vosburg, assistant United States attorney, Scranton, Penna., Herman F. Reich, Esq., asst. United States attorney, Sunbury, Penna., Llewllyn Jordan, Esq., special asst. to the Attorney General, Washington, D. C., attorneys for the plaintiff.

Ben Branch, Esq., Mauch Chunk, Penna., O'Brien & Kelly, Esq., Scranton, Penna., attorneys for John E. Zerbey, defendant. Ralph W. Rymer, Esq., Scranton, Penna., attorney for National Surety Company, defendant.

MEMORANDA AND ORDER

And now, December 26, 1924, this action has been brought to recover the penal amount of a bond (Form 738) for permit to use or sell distilled spirits and wines for other than beverage purposes, given in the sum of one hundred thousand dollars

($100,000.00) by the defendant, John E. Zerbey, as principal and the National Surety Company, as surety, to the United States of America, conditioned that the "principal shall fully and faithfully comply with all the requirements of the laws of the United States now or hereafter enacted and regulations issued pursuant thereto respecting the sale or use of distilled spirits and wines for other than beverage purposes." Recovery of the penal sum named is sought on the ground that the conditions of the bond, it is alleged, were breached by the principal charging him with having failed and neglected to comply with the requirements of the laws of the United States and the regulations issued in pursuance thereof, respecting the sale of distilled spirits for other than beverage purposes, and with further having unlawfully sold and disposed of large quantities of distilled spirits for beverage purposes and having diverted large quantities of said distilled spirits for other than nonbeverage purposes, in violation of the terms of the permit granted to him by the Federal Prohibition Commissioner, acting under and by virtue of the authority of the Commissioner of Internal Revenue.

The defendants deny liability, alleging as a legal proposition, that on the breach of the conditions of the bond, the plaintiff cannot recover the entire penal sum, without reference to the damages sustained, but can only recover the amount of the pecuniary loss, and as no pecuniary loss or damage is alleged to have been suffered by reason of the breaches of the conditions, plaintiff's actions can-

not be sustained. The legal question is presented whether the breach of the conditions of the bond renders defendant obligors liable for the full amount of its penal sum, or whether recovery shall be limited to actual damages sustained by the obligee. If the latter, the action cannot be sustained, but can only recover the amount of the pe- by defendants. If, however, the bond is a forfeiture bond and the full penalty is incurred upon breach of its conditions, the action may be sustained, provided the facts pertaining to the alleged breach are made to appear to the satisfaction of the court and jury.

The question has been variously answered and is not free from doubt; however, I am persuaded to accept as a guide to my conclusion, the well considered opinion of the Circuit Court in *United States* v. *Wandmaker*, 292 Fed. 24; which was followed by Judge McKeehan in *Francis O'Kane* v. *Ephriam Lederer, collector*, decided about August 12th, 1923, in the District Court for the Eastern District of Pennsylvania (unreported to date), and *United States* v. *United States Fidelity and Guaranty Company*, 1 Fed. (2d) 335, and by Judge Deitrich in *United States* v. *The National Surety Company et al.*, decided February 4th, 1924 (unreported to date), in which Judge Deitrich also cites and follows the *O'Kane* v. *Lederer case*, supra.

Judgment absolute will be entered dismissing the action. To which an exception is noted for the plaintiff.

12/26/24.

**UNREPORTED DECISION HANDED DOWN BY JUDGE DIETRICH IN THE DISTRICT COURT FOR THE DISTRICT OF IDAHO IN UNITED STATES v. THE NATIONAL SURETY COMPANY**

---

IN THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF IDAHO, CENTRAL DIVISION

*The United States of America*, upon the relation of E. G. Davis, U. S. Attorney for the District of Idaho, Plaintiff, v. *The National Surety Company, a corporation, and A. E. Carssow*, doing business under the firm name and style of the Carssow Drug Company, Defendants.

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MEMORANDUM DECISION

February 4th, 1924

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JOHN H. MCEVERS, Assistant United States Attorney, for the Plaintiff.

HAWLEY & HAWLEY for the Defendant National Surety Company.

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DIETRICH, District Judge:

The Government seeks to recover from the defendant Surety Company the full amount of the penalty of a bond given by it on behalf of one A. E. Carssow, a druggist who furnished the bond pursuant to the provisions of the National Prohibition Act and the regulations of the Department. Its contention is that upon a breach of the condition of the bond it may recover the full penal sum as liquidated damages, whereas the defendant contends that only actual damages can be recovered up to the

amount of the penalty. No actual damages are alleged or proved, and it therefore follows that if the defendant's theory is adopted the action must be dismissed.

Apparently there are no decided cases directly in point supporting the Government's position, but upon the other hand similar bonds have been construed in harmony with the defendant's view in *O'Kane* v. *Lederer, Collector*, decided in June, 1922, by the United States District Court for the Eastern District of Pennsylvania, and *United States* v. *Wandmaker* (8th C. C. A.), 292 Fed. 24 While the question is not entirely free from doubt, the reasoning of these cases is highly persuasive. The two forms of bond prescribed by the regulations undoubtedly have the same purpose, and if the permittee here had used the form which is attended with a deposit as collateral security, the liability upon a breach would not have been $2,000.00, but actual damages, including taxes, interest, penalties, etc. No reason is apparent why it should be held that the responsibility of the surety under the form of bond here involved is greater than the responsibility of a government bond put up as collateral under the other form of security.

Accordingly, judgment absolute will be entered dismissing the action.

○

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1925.

Nos. 120, 790.

EPHRAIM LEDERER, Formerly Collector, etc.,
v.
MARY A. McGARVEY, Executrix, etc.,

THE UNITED STATES
v.
JOHN E. ZERBEY AND NATIONAL SURETY COMPANY, a Corporation of the State of New York.

*On Certificates From the United States Circuit Court of Appeals for the Third Circuit.*

## BRIEF ON BEHALF OF NATIONAL SURETY COMPANY IN NO. 790.

RALPH W. RYMER,
*Attorney for National Surety Company.*

JOHN W. DAVIS,
JAMES M. NICELY,
*Of Counsel.*

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1925.

| | |
|---|---|
| EPHRAIM LEDERER, Formerly Collector, etc., v. MARY A. McGARVEY, Executrix, etc. | Nos. 120, 790 |
| THE UNITED STATES, v. JOHN E. ZERBEY AND NATIONAL SURETY COMPANY, A Corporation of the State of New York. | |

*On Certificates from the United States Circuit Court of Appeals for the Third Circuit.*

## BRIEF ON BEHALF OF NATIONAL SURETY COMPANY IN NO. 790.

### I.

### Statement.

These cases are here upon questions certified by the United States Circuit Court of Appeals for the Third Circuit, under Section 239 of the Judicial Code. A motion to advance both cases for argument together on a day certain was granted by this Court.

The certificates in each case ask identical questions—in substance, whether a Form 738 Permit Bond running to the United States is forfeitable in the full amount of its penal sum upon a breach of the condition therein, or whether the recovery upon a breach of the condition is limited to the actual damages sustained by the United States.

In both cases the decisions in the District Court (No. 120, in the Eastern District of Pennsylvania, 4 Fed. (2d) 418; No. 790 in the Middle District of Pennsylvania, unreported, printed herein page 52) sustained the contention of the permittee and the surety that the bond was an indemnity bond only, and that in the absence of any showing of damages by the United States, no recovery could be had.

The facts are concisely stated in the respective certificates, and in the Government's brief, but a short statement in No. 790 is made here for the Court's convenience.

## Statement of Facts.

The National Prohibition Act (41 Stat. 305) became effective January 16, 1920. Section 6 of Title II of the Act prohibits the manufacture, sale, transportation, etc. of liquor without first obtaining a permit. The Commissioner of Internal Revenue is authorized to issue such permit. The Section provides:

> "Before any permit is granted the Commissioner may require a bond in such form and amount as he may prescribe to insure compliance with the terms of the permit and the provisions of this Title." (41 Stat. 310).

A surety bond known as Form 738 covering liquor permits had been in use by the Treasury Department under the Food Control Act of August 10, 1917, 40 Stat. 282, the War Prohibition Act of November 21, 1918, 40 Stat. 1046 and the Revenue Act of 1918 (Approved February 24, 1919) 40 Stat. 1105. Treasury Decision 2940, approved October 29, 1919, was promulgated, among other things, to carry into

effect the quoted provision from Section 6 and to enforce the three earlier acts. It continued Form 738 in use for that purpose. Together with Form 738 a bond accompanied by the deposit of United States Bonds as collateral security, known as Form 738A was authorized. The applicant could elect which form he cared to execute.

Regulations 60 of the Treasury Department, approved January 16, 1920 and published February 1, 1920, provided in Section 20, for bonds known as Forms 1408 and 1409 to replace respectively Forms 738 and 738A. Paragraph (c) of Section 20 of these Regulations provided that bonds theretofore given on Forms 738 and 738A need not be replaced by the new forms, but would be effective until a new application for a permit accompanied by a new bond became necessary. The provisions of Regulations 60 thus were made applicable to Form 738 and 738A bonds. Forms 738, 738A and 1408 are reproduced on pages 55, 56 and 57 following.

John E. Zerbey duly applied to the Commissioner of Internal Revenue for a permit to sell distilled spirits and wines for other than beverage purposes to others holding like permits, and filed with the application a bond in the amount of $100,000 on Form 738, on which the National Surety Company was the surety. The application was filed and the bond dated January 23, 1920. A permit was duly issued on January 26, 1920.

The condition of the bond reads as follows:

> NOW, THEREFORE, the condition of this obligation is such that if the said principal shall fully and faithfully comply with all the requirements of the laws of the United States now or hereafter enacted and regulations issued pursuant thereto, respecting the sale or use of distilled spirits and wines for other than beverage purposes, then this obligation to be void; otherwise to remain in full force and virtue.

The United States commenced an action against Zerbey and the National Surety Company on the above bond in the

District Court for the Middle District of Pennsylvania on March 1, 1923. The complaint set forth the execution of the bond, the issuance of the permit, and four alleged violations of the condition of the bond occurring between March 6, 1920 and July 30, 1920, as follows:

> FIRST: Failure to record sales of spirits as provided in Section 10 of Title II of the Act and Section 58 of Regulations 60.
>
> SECOND: Sale and disposition of a large quantity of spirits for beverage purposes.
>
> THIRD: Diversion of a large quantity of spirits to other than non-beverage purposes.
>
> FOURTH: Possessing about thirty-six barrels of whisky withdrawn for non-beverage purposes from bonded warehouses subsequent to the effective date of the Act, without keeping appropriate record as required by Section 16 of Title II of the Act and Section 58 of Regulations 60.

It was alleged that by reason of these violations a cause of action accrued in favor of the United States for the full amount of the bond, to wit, $100,000, and that due notice and demand had been made upon the defendants, who refused to pay the same. No damages or injuries to the United States were alleged. Judgment in the full amount with interest from August 15, 1921 was prayed. The defendants filed so-called "affidavits of defense raising questions of law", which under Pennsylvania practice are the equivalent of demurrers.

The questions of law raised by the demurrers included the questions now before this court on the certificate. These questions in substance are:

> FIRST: Is a bond on Form 738 forfeitable upon breach of the condition in full amount of its penal sum?

SECOND: Is recovery upon breach of the condition of such bond limited to actual damages sustained by the United States?

The District Judge filed a brief memorandum on December 24, 1924, which has not been reported but which is printed as an appendix to this brief (p. 52). He sustained the contention of the defendants that the bond was an indemnity bond and not a forfeiture bond and ordered the entry of judgment absolute dismissing the action. The case was taken by writ of error to the Circuit Court of Appeals, Third Circuit, whence the certificate now before this court issued.

## Summary of Argument.

Form 738 is not a forfeiture bond. The condition in the bond must be construed by a consideration of its terms and of the statutory and administrative provisions authorizing its execution. The fact that it is a bond running to the United States, conditioned upon a full compliance with certain of its laws, does not predetermine its character.

The language of the condition is not that of a forfeiture bond. The purpose of the Commissioner of Internal Revenue and of the Treasury Department which must be considered in interpreting this language was to obtain indemnity only. Form 738A, an alternative bond, which the applicant might execute instead of Form 738 if he chose to do so, very clearly contemplated indemnity and not forfeiture. Form 738A may be considered when the purpose of Form 738 is sought to be ascertained.

The administrative purpose is further disclosed by the language of Treasury Decision 2940 and of Regulations 60. The basis of computing the bond prescribed in the Regulations discloses a purpose to obtain indemnity only. The Treasury Department has consistently taken the position in actual practice that Form 738 is an indemnity bond. The Government's interpretation of the bond involves the imposition of a double punishment upon a violator of the law for

a single offense—no such purpose was contemplated. In the present case this argument has peculiar force because Zerbey has already been punished for the offense herein charged to be a violation.

An examination of the statute discloses a purpose on the part of Congress to require indemnity only.

Revised States, Section 961, prevents the recovery of the full amount upon a Form 738 bond.

If Form 738 is held to be a forfeiture bond on its face, it represents an excess of power on the part of the Commissioner, which prevents its enforcement.

## ARGUMENT.

### POINT I.

**Form 738 is not a forfeiture bond. The condition in the bond must be construed by a consideration of its terms and of all the circumstances attending its execution.**

*The Nature of the Bond is not Predetermined by the Fact that the Bond runs to the United States.*

The problem presented by these cases is essentially a question of the construction of the language of the condition of this bond. Involved in that construction will be the plain meaning of the language itself, the purpose of the Commissioner in promulgating the bond, the purpose and scope of the regulations and statute authorizing the bond, and the consequences which were contemplated by the parties at the time the bond was written. As put by Judge McKeehan in rendering the opinion in the District Court for the Eastern District of Pennsylvania in No. 120 (4 Fed. (2d) 418, 419):

> "The question is always one of construction having regard to the entire statute, the governmental regulations framed to carry out the statute and the language of the bond."

The condition of the bond reads:

> "NOW, THEREFORE, the condition of this obligation is such that if the said principal shall fully and faithfully comply with all the requirements of the laws of the United States now or hereafter enacted and regulations issued pursuant thereto, respecting the sale or use of distilled spirits and wines for other than beverage purposes, then this obligation to be void; otherwise to remain in full force and effect."

Looking at the naked language of the condition, it is evident that no liability in a fixed sum is established for any specific deed or misdeed. The condition calls in broad terms for compliance "fully and faithfully * * * with all the requirements of the laws of the United States now or hereafter enacted and regulations issued pursuant thereto". Upon the Government's interpretation of this language the full penal sum of $100,000 would be forfeitable upon the slightest failure to comply with the requirement of any regulation issued before or after the execution of the bond and pursuant to a law of the United States respecting the sale or use of distilled spirits and wines for other than beverage purposes.

In addition to the National Prohibition Act and Acts supplementary thereto, there are other laws covered by the language of this bond. The regulations which have been issued in pursuance of the National Prohibition Act, and the other laws, have been numerous. It is at once apparent that the obligations covered are multiple and diverse, and that a failure fully to comply with any one of them would render the principal and surety liable in the full amount upon the Government's theory. Under these circumstances a familiar principle becomes applicable, viz. that the amount of a bond contingent upon the performance of many and diverse conditions is to be viewed as a maximum of liability, or as a limit of indemnification for damages resulting from the breach of any of the conditions, and not as an amount of liquidated damages or a penal sum recoverable in the full amount. This conclusion has been reached upon the theory that the

parties could not have intended by a blanket-provision to liquidate damages in a fixed sum to cover breaches, some of which might be trivial.

The Government's case in substance is, in effect, to limit this principle to bonds running between private individuals, and to insist that it does not cover bonds running to the United States conditioned upon a compliance with its laws.

The differences between bonds running to the Government conditioned upon a compliance with its laws and those running between individuals conditioned upon the performance of certain obligations are obvious, but the argument which the Government attempts to deduce therefrom, namely, that upon the breach of a condition in a government bond, the full amount named is at once forfeitable, is erroneous and has no support in the authorities.

In the case of bonds running between private individuals, the problem is always one of construction, as to whether the amount named in the bond is to be viewed as liquidated damages or merely as a limit of indemnification. *Sun Printing & Publishing Assn.* v. *Moore*, 183 U. S. 642, 672. All the circumstances entering into the execution of the bond must be considered.

Likewise, in the case of bonds running to the Government conditioned upon compliance with its laws, or upon the performance of some public duty, the problem is one of construction. Included in the circumstances to be considered will be the fact that the bond was issued in conformity with some governmental regulation or statute and in pursuance of some governmental object, and there will also be the circumstance that damages to the Government, if any, for a breach of its laws, may not be readily ascertainable. But the ultimate result of this process of construction is not to be predetermined by the preliminary fact that the bond is one running to the United States. The position of the Government embodies an attempt so to predetermine the question. The position of the principal and surety is that the problem of construction is not affected by the character

of the obligee, except as that character is a circumstance to be considered.

In the leading case relied on by the Government, *Clark* v. *Barnard*, 108 U. S. 436, where a bond running to the State of Rhode Island was conditioned upon the completion of a railroad by a certain date, this Court approached the question of the construction of the bond in the manner above outlined. All the circumstances attending its execution were considered, and in arriving at a conclusion the Court said at page 459:

> "The proper solution of the question now under examination is to be found in two principal considerations.
>
> The first of these is that *it was not intended by the parties* * * * that the obligation given and accepted should be for an indemnity against any loss or damage expected to be suffered by the State. * * * The question of damages and compensation was not, because it could not have been, *in contemplation of the parties.* * * *
>
> In the second place, we think that the sum named in the *statute* is imposed by it as a *statutory* penalty for the nonperformance of a *statutory* duty * * * We must construe it, *ut res magis valeat quam pereat.*"*

It is clear from the above quotation that the Court viewed the problem as one of construction, and that the fact that the bond ran to the State and that the State could suffer no damage by the default were only some of many circumstances affecting the inquiry. The factors which ultimately turned the scale were, first, the intention of the parties, and second, the purpose and language of the authorizing statute.

In *U. S.* v. *Montell*, 26 Fed. Cas. 1293 (Case No. 15798) (1841), decided by Chief Justice Taney, sitting at Circuit, where the question was as to the liability upon a bond running to the United States conditioned upon the use of the registry of a vessel solely for the vessel for which it was granted, upon refraining from disposing of the registry, and

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*Italics ours throughout this brief unless otherwise indicated.

upon its prompt delivery to the Collector if the vessel be lost or sold, the entire opinion is devoted to a careful effort to construe the bond in the light of its language, the provisions of the Act which expressly authorized it, and all the other provisions of the same Act which were capable of shedding any light upon its meaning. There is no suggestion in the opinion that bonds running to the United States enjoy a peculiar status. The oft-quoted phrase from this opinion, upon which the Government now relies (Government's brief, p. 27), to the effect that damages to the United States in the event of a breach of the condition of such a bond are difficult of ascertainment, if, indeed, they exist at all, was used by Chief Justice Taney only to illustrate one of the circumstances important in arriving at a fair construction of the meaning of the bond.

Similarly in *U. S.* v. *Dieckerhoff*, 202 U. S. 302, 311 (1906), wherein was involved the question of the amount due upon a bond running to the United States covering the return unopened of an imported article withdrawn by the importer before appraisal, the burden of the opinion is an effort to find what the bond meant by an examination particularly of the purpose of its authorizing statute and the meaning of its terms.

At page 312, after alluding to arguments which had been made to influence the Court's construction, the opinion reads:

> "But the contract is definite in its terms. * * * But we do not think these considerations should overcome the *purposes of the statute* and *terms of the obligation* incurred in the giving of this bond."

The same approach has been consistently followed by the lower Federal Courts in construing bonds of this type. *U. S.* v. *Alcorn*, 145 Fed. 995, 999 (Circuit Court, W. D. Mo. 1906); *U. S.* v. *Cutajar*, 59 Fed. 1001, 1002; aff'd 67 Fed. 530, 531 (2d C. C. A. 1895); *The S. Oteri*, 67 Fed. 146 (5th C. C. A. 1894). Some support for the Government's contention may be found in *Illinois Surety Co.* v. *United States*, 229 Fed. 527 (2d C. C. A. 1915) (see pp. 28, 29, Government's

brief). If the case has not been satisfactorily distinguished in its own Circuit in *United States* v. *United States Fidelity & Guaranty Co.*, 1 Fed. (2d) 335 (W. D. N. Y. 1924), it is respectfully submitted that it is out of harmony with the decisions of this Court discussed above.

As previously pointed out in this brief, the approach of the District Court in No. 120 was precisely in line with that approved in the decisions just referred to. Similarly, in No. 790, it is evident from the brief opinion of Judge Witmer that he approved the method adopted by Judge McKeehan in No. 120. Each of these District Court decisions refers with approval to the decision of the Circuit Court of Appeals for the 8th Circuit in *U. S.* v. *Wandmaker*, 292 Fed. 24, 27 (1923), in which the argument that a bond on Form 738 ran to the United States, and hence, without more, should be considered a forfeiture bond, was held not to overcome the evident purpose, expressed in the language of the bond and in the regulations authorizing it, that indemnity only was being sought.

Emphasis has been placed at the outset upon the point that the character of these bonds is not predetermined by the fact that they run to the United States, because the Government has attempted so earnestly in all the cases heretofore raising this question and in its present brief (pp. 21-33), to establish this contention. We repeat that the facts that the bond runs to the United States and that it was issued under the authority of statutory requirements and in pursuance of governmental regulations are only circumstances to be considered along with all the circumstances properly affecting the construction of this bond. The cases relied upon by the Government in which forfeiture was decreed will be found to display a statutory penalty, an express statutory forfeiture, a direction of distribution which showed that the full amount was to be collected, or a situation in which the breach of condition did not subject the violator to any definite penalties prescribed by law. In none of these cases do the principles decided or the facts apply here.

We turn now to the construction of the bond itself.

## A. The language of the condition is not that of a forfeiture bond.

The language of the condition, previously quoted, covers many and diverse acts. It includes "all the requirements" of the laws and regulations issued pursuant thereto respecting the sale or use of distilled spirits and wines for non beverage purposes. It calls for a full and faithful compliance with these requirements. It covers a large variety of what might be termed major offenses for which the National Prohibition Act, in Sections 29 and 35 of Title II, and Regulations 60, Section 101, impose penalties. It covers many minor regulations for which no penalty is provided by the Act or the Regulations. The bond has been executed, according to its terms, to insure full compliance with all of these requirements. It would be an extravagant assertion to say that $100,000 was to be forfeited upon the failure to comply "fully" with the requirement of some minor regulation promulgated by the Commissioner, *e. g.* that the label to be affixed by an authorized seller must be rectangular in form

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*The requirement of the rectangular label is merely illustrative of many provisions in the Act and Regulations, the failure to comply with which would be a "violation" within the meaning of the condition of the bond, as the Government construes it. The following list of similar requirements displays the absurdity of the Government's contention:

THE NATIONAL PROHIBITION ACT:

*Section 6, Title II:* The manufacture, sale, purchase or transportation of one bottle of intoxicating liquor ("any liquor") for beverage purposes is a violation.

*Section 9, Title II:* A permittee violates his permit if he violates "the laws of any state relating to intoxicating liquor."

*Section 12, Title II:* Labels on manufactured liquor must be "clearly and permanently" attached to every container thereof, and must state "the name of manufacturer, kind and quantity of liquor contained therein, and the date of its manufacture, together with the number of the permit authorizing the manufacture thereof." An error in statement as to date of manufacture would be a violation of this section.

*Section 14, Title II:* This section makes it a violation for any person to receive liquor from a carrier unless the package containing the liquor

(Sec. 95, Regs. 60), for a violation of which neither the Commissioner nor the statute attempts to impose any penalty.*

Where a bond in large amount has been given to insure compliance with requirements so numerous and so varying in importance, and where the amount of the bond is grossly disproportionate to any penalty which might be imposed for a violation of a minor requirement, it is obvious that indemnity is the purpose of the bond and not punishment.

This situation is analogous to that presented by bonds given by private individuals to insure the performance of contract obligations. The question there arising of whether the bond is for liquidated damages or for security is like the question here involved of whether Form 738 is a forfeiture or indemnity bond. Congress has occasionally used the private bond terminology for government bonds. In the Act of June 23, 1874 (18 Stat. 235) providing for bonds for postal carriers, the statute says that recovery by the United States shall be "as *liquidated damages*, to be recovered in an action of debt on the said bonds." See *United States* v. *Alcorn*, 145 Fed. 995 (C. C., W. D. Mo. 1906).

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gives the following information on the outside: "Name and address of consignor or seller and consignee, kind and quantity of liquor contained therein, number of permit to purchase or ship, together with the name and address of the permittee." The omission of the address of the permittee would be a violation of this section.

*Section 17, Title II:* Under this section, if a person permitted a sign or billboard containing an advertisement for liquor to remain upon his premises, he would violate the Act. It would be amazing if this offense could result in a forfeiture of $100,000 on a permit bond.

*Section 18, Title II:* Under this section the mere possession of a utensil, preparation, formula or recipe advertised, designed, or intended for use in the unlawful manufacture of intoxicating liquor is a violation of the Act.

*Section 19, Title II:* The giving of any information as to how liquor may be obtained unlawfully is made a violation of the Act under this section.

*Section 21, Title II:* Under this section any room, house, boat or vehicle or other place where intoxicating liquor is manufactured, sold

In the private bond case it is well settled that the sum will not be regarded as liquidated damages where the condition in the bond makes it payable upon the occurrence of any one of many events, varying in relative importance, for some of which the damages are readily ascertainable, for others not. This is upon the very tenable theory that the parties could not have intended to liquidate in a large amount the damages occasioned by a trifling breach. So in the case of a government bond a large forfeiture sum cannot have been intended to cover trifling violations, and broad language in a bond must not be so construed. *United States* v. *Rubin*, 227 Fed. 938, 942 (E. D. Pa. 1915).

The principle was alluded to by Chief Justice White in his opinion in *Sun Printing & Publishing Association* v. *Moore*, 183 U. S. 642 (1902). After citing *Quinn* v. *United States*, 99 U. S. 30; *Clark* v. *Barnard*, 108 U. S. 436, 454; *Watts* v. *Camors*, 115 U. S. 353, 360; and *Bignall* v. *Gould*, 119 U. S. 495, the Chief Justice said (p. 664):

> "The last cited case illustrates the character of disproportion apparent on the face of a contract which

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or kept in violation of the law is declared to be a common nuisance and any person who maintains such nuisance is guilty of a misdemeanor and may be fined not more than $1,000 or imprisoned for not more than one year or both. Is it to be assumed that he may also be compelled to forfeit $100,000 if he happens to be a permittee under a Form 738 Bond?

*Section 23, Title II:* Under this section, if an employee of an individual carries any liquor on his person with intent to effect a sale thereof, or who "shall travel" to solicit or accept orders for an unlawful sale, the employer of such person has violated the Act.

REGULATIONS 60.

*Section 27, Art. IV:* Under this section a violation occurs if after spirits have been bottled in bond and before they have been placed in cases, "a label proportionate in size to the size of the bottle" (whatever "proportionate in size" may mean) has not been placed upon each bottle.

*Section 55 (g), Art. VIII:* Under this section the failure by both the vendor and the applicant for a permit for procuring and delivering intoxicating liquor must file "chronologically" a copy of the permit to

> has influenced a court when endeavoring to ascertain the meaning of parties to a contract in a stipulation for the payment of a designated sum for the breach of a condition. There the penal sum was $10,000, several breaches of the conditions of the bond might be committed, to each of which a stipulated sum would be applicable, and one such breach might be the failure to obtain a release of a claim of but Ten dollars."

On page 672 he referred again to the principle as follows:

> "It may, we think, fairly be stated that when a claimed disproportion has been asserted in actions at law, it has usually been an excessive disproportion between the stipulated sum and the possible damages resulting from a trivial breach *apparent on the face of the contract*, and the question of disproportion has been simply an element entering into the consideration of the question of what was the intent of the parties, whether *bona fide* to fix the damages or to stipulate the payment of an arbitrary sum as a penalty, by way of security." (italics the court's).

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purchase covering each shipment or delivery. A non-chronological filing would violate this regulation.

*Section 88, Art. XVI:* Under this section a permittee to transport is required to file in permanent fashion at the point of destination "in a file or binder separate from other records, a copy of each form of permit to purchase or application upon which liquor is delivered by him." The filing of such copy in the same binder with other records would violate this regulation.

*Section 92 (a), Article XVI:* The acceptance by a consignee of a package containing liquor, upon which appears a statement known by him to be false is a violation of this regulation.

*Section 95, Article XVIII:* The regulation that the labels be rectangular in form has been referred to in the text. Paragraph (a) of this regulation requires that labels be clearly pasted "to the commercial head of barrels." And "in the case of wooden containers, must be secured thereto by five tacks, one in each corner and one in the middle of the label." Upon the Government's contention $100,000 would be forfeitable for the use of four tacks.

Paragraph (b) of this section will be violated if any person defaces a label "in any manner whatever."

A long line of state decisions have established the same principle, and they are collected in the foot note.*

In *City of Summit* v. *Morris County Traction Co.*, 85 N. J. L. 193, 88 Atl. 1048, the New Jersey court had before it a bond given to insure full compliance with a city ordinance in language approximating Form 738. The doctrine referred to by Chief Justice White was applied to such bond, although it covered a public duty, the court saying (p. 195):

> "That when damages are to be ascertained for the breach of a single stipulation contained in an agreement, and they are uncertain in amount and not readily susceptible of proof under the rules of evidence, then if the parties have agreed upon a sum as the measure of compensation for the breach, and that sum is not disproportionate to the presumable loss, it may be recovered as liquidated damages (citing authorities); but where the agreement contains disconnected stipulations of various degrees of importance, the sum named therein to be paid in case of a failure of performance will be considered as a penalty, unless the agreement specifies the particular stipulation or stipulations to which the liquidated damages are to be confined."

In Bond Form 738 this principle of construction applies. Where as here, the acts covered are diverse and numerous, and where many of the violations would be trivial, it is not to be assumed that the Government intended in the bond

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*_Henry_ v. _Louisville & Nashville Ry._, 91 Ala. 585, 8 So. 343;
_Kelly_ v. _Fejervary_, 111 Iowa 693, 83 N. W. 791;
_Hahn_ v. _Horstman_, 12 Bush. (Ky.) 249;
_Mason_ v. _Callender_, 2 Minn. 350;
_Carlin, etc., Co._ v. _Boatman_, 84 Mo. App. 67;
_Fisk_ v. _Gray_, 11 Allen (Mass.) 132;
_City of Summit_ v. _Morris County Traction Co._, 85 N. J. L. 193, 88 Atl. 1048;
_Raymond_ v. _Edelbrock_, 15 N. Dak. 231, 107 N. W. 194;
_Keck_ v. _Bieber_, 148 Pa. 645, 24 Atl. 170;
_Lange_ v. _Werk_, 2 Ohio St. 519;
See also in England _Davies_ v. _Penton_, 6 Barn. & Creswell, 216.

to do the equivalent of liquidating damages, i.e., fixing a definite forfeiture sum for any violation no matter how trivial.

The consequence of a failure to comply with any of the requirements of the Act or of its regulations have been defined in detail by the Act. For some offenses fines are to be imposed, for others fines together with imprisonment, for others, assessments of double taxation, for others the loss of a privilege previously granted, for others no specific punishment. A bond in the amount of $100,000 conditioned upon a full compliance with all these requirements could have only one appropriate purpose, namely, the assurance to the obligee that a failure to comply with the requirements would be met promptly by a satisfaction of the penalties imposed--in short, indemnification.

The language used is broad and indefinite. It endeavors to be all inclusive. This is not language characteristic of a forfeiture bond. No act is specifically prohibited, the doing of which would call for full liability upon the bond. On the other hand, it is characteristic of an indemnity bond that it covers broadly a variety of obligations. It is not essential in an indemnity bond that the principal and the surety be accurately aware of the precise obligations which their bond covers in the sense that that is necessary in a forfeiture bond.

The requirement of some minor regulation promulgated by the Commissioner might not be complied with fully by the principal under a Form 738 bond, and he would never be aware of the existence of the Regulation or of his failure to comply with it, and the Commissioner might take no steps to reprimand the principal for his violation. Yet under the Government's construction, the principal and the surety would have become liable for $100,000. The construction may be tested by the extreme case suggested, for it serves to illustrate the validity of the familiar principle that in a forfeiture bond the conditions must be set forth exactly.

This court in *United States* v. *Choteau*, 102 U. S. 603, had before it a bond executed by a distiller in pursuance of Revised Statutes, Section 3260. The condition of the bond was as follows: that the principal "shall in all respects faithfully comply with all the provisions of the law in relation to the duties and business of distillers, and shall pay all penalties incurred or fines imposed on him for a violation of any of the said provisions."

The bond was in the amount of $25,000. The United States sued on the bond charging two violations. The first was an alleged concealment of entries of liquor stocks whereby the Government was defrauded out of taxes in the amount of $2,100. The defense was that the United States had not been damaged as a result of the acts alleged. Mr. Justice Field in sustaining the defense said on page 608:

> "Here a specific omission of duty on the part of the distiller is alleged, for which it is sought to charge both him and his sureties on their bond. *Their liability is only to the extent of the damages sustained.* If none resulted to the United States from the omission stated, none can be recovered either against him or his sureties. The law does not affix any specific penalty for the omission. If, therefore, the allegations of the petition were simply traversed, the government would be compelled to prove, not only the omission complained of, but that by means of it the tax on the spirits produced was lost, which constitutes the damages alleged."

In this quotation it appears that this court decided that a bond in form very similar to Form 738 was an indemnity bond only, on which nothing could be recovered in the absence of any showing of damages. The only difference in form between that bond and Form 738 lies in the specific inclusion of the provision covering taxes, not present in Form 738. But a reference to Section 20, Regulations 60, discloses an authorizing regulation in language almost exactly the same as that used in the bond authorized by Revised Stat-

utes, Section 3260, and in the words of the statute itself. Form 1408, which came into use in 1920, in place of Form 738, and to accomplish the same end, employed language very similar to the condition of the distiller's bond quoted above. The condition of Form 1408 reads:

> "Now, therefore, the condition of this obligation is such that if there be no material false statement in the application for such permit, and the said principal shall not violate the terms of such permit issued to him by the Commissioner of Internal Revenue, * * * or *shall not violate any of the provisions of the National Prohibition Act* and regulations promulgated thereunder as now or hereafter provided, and all other laws of the United States now or hereafter provided respecting distilled spirits, etc., *and will pay all taxes, assessments, fines and penalties incurred or imposed upon him by law*, then this obligation to be void, otherwise to remain in full force and effect." (For the full text of the bond, see p. 57, *infra*).

Under the *Choteau* decision no recovery could be had on a Form 1408 bond in the absence of a showing of damages to the United States directly attributable to the violation relied upon in the suit upon the bond. Upon a consideration of the regulations authorizing Form 738, of the condition incorporated in Form 1408, of Revised Statutes §3260, of the bond issued thereunder, and of the decision of this court in *United States* v. *Choteau*, it is submitted that the language of 738 must be construed to contemplate an idemnity bond only.

Upon the language alone, then, it is clear that Form 738 is not a forfeiture bond.

### B. The Purpose of the Commissioner and Treasury Department was to obtain indemnity only.

The purpose of the Treasury Department and the Commissioner of Internal Revenue in requiring a Form 738 bond discloses an attempt only to indemnify the United States,

not to endow it with additional fines and penalties for a violation of its law. Form 738 had been used before the date at which the National Prohibition Act became effective. It was first used under the Food Control Act of August 10, 1917 (40 Stat. 273) and continued to be used under the War Prohibition Act of November 21, 1918 (40 Stat. 1046) and under the Revenue Act of 1918 (40 Stat. 1057) passed February 24, 1919. Its use was sanctioned by Treasury Decision 2940, approved October 29, 1919.

*Form 738A discloses a purpose to require indemnity only.*

Throughout all its uses, Form 738 was always associated with Form 738A. The latter form with immaterial variations contained exactly the same language as Form 738, except that there was an added statement attached to the condition heretofore quoted. The respective conditions of the two bonds appear in the following parallel columns:

| *Form 738.* | *Form 738A.* |
|---|---|
| Now, therefore, the condition of this obligation is such that if the said principal shall fully and faithfully comply with all the requirements of the laws of the United States now or hereafter enacted and regulations issued pursuant thereto respecting the sale or use of distilled spirits and wines for other than beverage purposes, then this obligation to be void; otherwise to remain in full force and virtue. | Now, therefore, the condition of this obligation is such that if the said principal shall fully and faithfully comply with all the requirements of the laws of the United States now or hereafter enacted and regulations issued pursuant thereto respecting the sale or use of distilled spirits and wines for other than beverage purposes, then this obligation to be void; otherwise to remain in full force and virtue, *and the said principal expressly agrees* that the said bonds so deposited may be sold at public or private sale, with |

> or without notice of said sale and without notice of any character to the principal, and the proceeds applied to the payment of any internal revenue taxes, interest, and penalties which may be due, and in satisfaction of any liabilities incurred hereunder and the expenses of such sale, if any; and the residue, if any, paid to the said principal.

The language of the two bonds is identical down to the italicized words in Form 738A.

As is apparent from the above language, Form 738A was a bond accompanied by a deposit of collateral security (in the form of Liberty or other bonds of the United States). The collateral was deposited in lieu of the undertaking of a surety. The principal might elect which of the two forms he would execute. Treasury Decision 2940 §15 (c). The two forms were designed to accomplish the same purpose, couched their major condition in the same terms, and were equally available for use by the applicant.

The National Prohibition Act became effective on January 16, 1920. Regulations 60, issued pursuant thereto, were approved the same day but not published until February 1, 1920. Regulations 60 authorized new forms of bonds to be executed by permittees, known as Forms 1408 (surety bond) and 1409 (collateral bond). It was provided, however, in Regulations 60, Section 20, (c) that where the holders of permits to use or sell non-beverage spirits or wines had already given bond as provided in Treasury Decision 2940, no new bond need be furnished until applications for new permits became necessary, at which time bonds on Form 1408 or Form 1409 were to be filed. The bond executed by Zerbey and the National Surety Company involved in Case No.

790, was executed on January 23, 1920. At this time Form 738 was still being used and Form 1408 had not been promulgated, although the National Prohibition Act had become effective on January 16, 1920. The use of Form 738 was therefore proper under Section 20 (c) of Regulations 60, as previously explained.

An examination of the language of Form 738A at once makes clear that the Commissioner's purpose was indemnity only. The provision is that the Liberty or other bonds deposited as collateral may be sold without notice upon a failure "fully" to comply with all the requirements of the laws of the United States and Regulations issued pursuant thereto, and that the proceeds from such sale are to be applied "to the payment of any internal revenue taxes, interest and penalties which may be due, and in satisfaction of any liabilities incurred hereunder and the expenses of such sale, if any"—then comes the important provision—"and the *residue*, if any, paid to the said principal." If the bond were intended to be a forfeiture bond, there would be no residue. There would be no application of the proceeds of a sale of the collateral to the payment of any taxes, interest, penalties, or the satisfaction of any liabilities. If the bond were a forfeiture bond, the entire deposit would be sold at once and the entire proceeds forfeited to the United States. But the language of the bond provides expressly that the only amount to be retained by the United States after the sale is an amount realized from the proceeds sufficient to discharge any liabilities on account of taxes, interest, penalties, etc. Any residue thereafter remaining belongs to the principal.

A sum deposited as collateral was to be used only to assure the United States that sums lawfully due it for a violation of its laws would be promptly paid. The United States sought to impose no further penalties upon the holder of a permit than were already imposed by its laws and regulations. The holder of the permit clearly understood when he signed Form 738A that the limit of his liability was the

amount of any fines, taxes, interest, etc., which he might owe to the United States because of a failure on his part fully to comply with the requirements of its laws. Beyond such sums, his collateral deposit was not to be touched.

Form 738 was merely another type of bond which the applicant might execute to entitle him to the same permit as if he had executed Form 738A. His choice would be determined by his preference for a surety bond or for a bond accompanied by a deposit of collateral. *But the significant point is that the choice lay with him.*

When these bonds were replaced by the new forms (1408 and 1409), it is important to note that there were two forms recommended—one a surety bond to replace 738, the other a collateral deposit bond to replace 738A, with the same election open to the permittee. The identical purpose lay back of the bonds in either of these pairs of forms.

It has been pointed out above that that purpose, viz., indemnity, was adequately disclosed in Form 738 by the fact that an enormous sum was fixed in a bond conditional upon multiple and diverse obligations, some of which were grossly disproportionate to the sum named. But if any doubt exists as to the purpose disclosed in the language of Form 738, the language of Form 738A entirely removes the doubt. The latter form clearly contemplated indemnity only. Indeed, the United States, under the latter form, expressly agreed to limit its claim to indemnity only. In view of the fact that the election as to which form would be used lay with the applicant, and not with the United States, the purpose of the Commissioner behind both bonds may be ascertained by a consideration of either of them. So far as the United States was concerned, either bond would achieve the purpose.

*The Lower Federal Courts Have Adopted This Argument.*

This is the argument which has prevailed heretofore in the majority of the lower Federal courts. Upon this ground the Circuit Court of Appeals for the 8th Circuit in *U. S. v. Wandmaker,* 292 Fed. 24, approved the contention here ad-

vanced by the Surety Company. This reasoning was expressly approved by District Judge Witmer, who heard No. 790 below. It was also approved and adopted by Judge Hazel in *U. S.* v. *U. S. Fidelity & Guaranty Co.*, 1 Fed. (2d) 335 (W. D. N. Y.); by Judge Dietrich in *U. S.* v. *National Surety Co.* (D. Idaho—unreported—Feb. 4, 1924), and by Judge Garvin in *U. S.* v. *American Surety Co.* (E. D. N. Y. —Oct. 7, 1924). In *United States* v. *Engelberg*, 2 Fed. (2d) 720 (W. D. Pennsylvania) the Government's contention prevailed, as also in *United States* v. *U. S. Fidelity & Guaranty Co.* (D. Maryland—1924) now on writ of error in the Fourth Circuit Court of Appeals. In the *Wandmaker* case, the court said, affirming Judge Amidon (D. North Dakota) (292 Fed. 24, 28):

> "The two forms of bond, either of which the permittee had the right to give, are identical in obligation. If the form requiring deposit of Liberty or other U. S. bonds had been given by Wandmaker, there can be no doubt that the ruling on the demurrer was right. The $2,000 named in the bond would not have been an agreed sum to be forfeited on breach but a penal sum to secure damages suffered in taxes, interest, penalties and other liabilities of the permittee unpaid. How, then, can the application in the form that was used be said to be different? We fail to find any reason for so holding. The two forms of bond were for the same purpose. We think the principle announced in the cases relied on has no application here."

In *United States* v. *U. S. Fidelity & Guaranty Co.*, 1 Fed. (2d) 335, 337, Judge Hazel said:

> "The reasoning in part predicated upon the bond without surety (both forms of bond having been given by the permittee, one to buy the alcohol, and the other to use it) requiring a pledge of Liberty Bonds as collateral is also applicable to the bond given with surety in lieu of a pledge. It is applicable to the form of bond with which we are herein concerned, and I am in

> agreement with the interpretation of the terms of the bonds as stated in the Wandmaker Case and the reasons assigned in support thereof. The authorities cited by the United States attorney upon the point that the full amount of the bond was forfeited for the breach have been examined by me but they are readily distinguishable."

In *United States* v. *National Surety Co.*, Judge Dietrich said:

> "The two forms of bond prescribed by the regulations undoubtedly have the same purpose, and if the permittee here had used the form which is attended with a deposit as collateral security, the liability upon a breach would not have been $2,000.00 but actual damages, including taxes, interest, penalties, etc. No reason is apparent why it should be held that the responsibility of the surety under the form of bond here involved is greater than the responsibility of a government bond put up as collateral under the other form of security."

It will thus be seen that two Circuit Judges, Sanborn and Lewis, and seven District Judges, McGee, Amidon, Hazel, Garvin, Dietrich, McKeehan and Witmer, have sustained the contention of the Surety Company. Two District Judges, Thomson and Soper, have sustained the contention of the Government.

*Other Indications of the Administrative Purpose.*

But in addition to the statement of the Commissioner's purpose disclosed in Form 738A, there are other indications which the Department has given of its intention to require indemnity only. Treasury Decision 2940 and Regulations 60, which must be read in ascertaining the meaning of the bond which they authorized disclose an intention to require indemnity only.

*Treasury Decision 2940.*

Treasury Decision 2940, in paragraph 17 (c) reads:

> "In each and every case where the holder of a permit retires from that business and surrenders his permit to the Prohibition Officer of the State, *and there are no outstanding charges against his bond,* the Prohibition Enforcement Officer will promptly notify the Commissioner of Internal Revenue in order that the bond of the holder of the permit may be cancelled as to future liability." (Italics ours.)

From this it is plain that the Commissioner contemplated that bonds on Form 738 and 738A were given to assure payment to the United States of "outstanding charges". If forfeiture were contemplated, no question of outstanding charges could be involved. The full sum would be due upon the bond and any *liabilities* resulting from violations of the law by the permittee would be established in independent prosecutions or claims.

In Section (e) of the same paragraph 17, the following statement occurs: "The bonds issued in connection with the permits covered by each Treasury decision will be cancelled as to all *liabilities* arising more than thirty days after the publication of such decision." Clearly a forfeiture bond would not be affected by "liabilities". One liability alone would forfeit its full amount. Various "liabilities" could refer only to such diverse charges as fines, interest, penalties, taxes, etc., the type of charge which Form 738A expressly specified and which evidently was likewise all that was contemplated in Form 738.

*Regulations 60.*

Regulations 60, approved January 16, 1920 and published February 1, 1920 and which applied to Form 738 as well as to 1408 which succeeded it, discloses the same purpose on

the part of the Treasury Department to require an indemnity bond and not a forfeiture bond to cover permits for dealing in liquor. Section 24 renewed the cancellation provision of Treasury Decision 2940 as follows:

> "In any case where the holder of a permit surrenders the same to the Director and there are no *outstanding* charges against his bond, the Director should promptly notify the Commissioner, and on notice from the Commissioner that the bond is canceled, should cancel the copy of the bond in his files and notify the surety of such cancellation."

Again in paragraph (a) in the same section there is a reference to "outstanding charges" against the bond and in paragraph (b) of the same section there is a reference to "any liabilities or charges" which may have arisen or been incurred prior to cancellation of a bond. These references to charges and liabilities are meaningless when applied to a forfeiture bond, but they are significant when applied to an indemnity bond. On this subject the Eighth Circuit Court of Appeals in the *Wandmaker* case said, 292 Fed. 24, 26:

> "We take the expression, 'in satisfaction of any liabilities incurred hereunder,' to be a broad inclusion of such liabilities to which the permittee might subject himself under the Prohibition Act, which authorized the issuance of the two permits. It is certainly broad enough to include them, and we see no other purpose in its use. By association it has reference to liabilities to be incurred for other penalties. We think it clear that the whole purpose of this form of bond was to secure payment of all liabilities on the part of the permittee to which he might be subjected in virtue of having received the permits."

In Section 22 of Regulations 60 there is the following sentence (a similar expression is to be found in Section 55(a)):

> "Whenever the quantity of intoxicating liquors or other preparations *debited against the bond* is such

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In Section 22 of Regulations 60 there is the following sentence (a similar expression is to be found in Section 55(a)):

> "Whenever the quantity of intoxicating liquors or other preparations *debited against the bond* is such

> that the existing penal sum is not sufficient a new bond must be furnished in sufficient sum to cover all liability."

This sentence when read in connection with the sections presently to be noted respecting the manner in which the amount of the bond was determined shows very plainly that the amount of the bond bore a fixed relation to the amount of liquor covered by the permit issued to the principal. If a forfeiture bond were contemplated no direct relation between the amount of the bond and the amount of the liquor would necessarily be employed. A forfeiture bond would cover many violations of the law which would have nothing to do with the quantity of liquor covered by the permit. On the other hand an indemnity bond covering taxes, interest, fines, etc., would be graduated according to the varying possibility of liabilities to be indemnified. The liabilities of the type mentioned would bear a direct proportion to the quantity of liquor covered by the permit. It follows that the manner in which the amount of the bond was related to the quantity of liquor discloses the purpose on the part of the Department to obtain indemnity only.

The first sentence of Section 20 of Regulations 60 reads as follows:

> "All persons desiring to obtain permits, provided by these regulations, except as provided below, must at the time or before the time of filing application therefor, file with the Director a bond in duplicate on Form 1408 or Form 1409 to insure compliance with the provisions of this Act and of these Regulations *as well as* to cover any taxes and penalties which may be imposed under the Internal-revenue Laws."

From this sentence it is clear that the purpose of the Department was to obtain indemnity with respect to taxes and penalties which might be imposed upon permittees for violations. The significance of the use of the expression "insure compliance with the provisions of this Act * * *

as well as to cover any taxes", etc., will be adverted to later, but at this point it is sufficient to observe that the Department was expressly seeking indemnity. This is the argument that received the greatest attention when *Lederer* v. *McGarvey* was decided in the District Court. Judge McKeehan said, 4 Fed. (2nd) 418, 420:

> "Be that as it may, and without considering what forms and amounts of bonds might be required by the Commissioner in the exercise of the power delegated to him, it is evident that the particular bond now before the court, read in connection with the regulation under which it was executed, does not name $2,000 solely as a penalty or punishment for a noncompliance with the terms of the permit and title 2 of the act.
>
> The amount named is expressly stated to cover also any taxes and penalties imposed under the internal revenue laws and to insure compliance also with all the laws thereafter enacted, and regulations issued pursuant thereto, respecting the sale and use of wines and spirits for other than beverage purposes. It follows that the $2,000 named in the bond cannot all have been intended as a fixed penalty or punishment for a violation of the permit and title 2 of the Prohibition Act. I cannot but conclude, therefore, that the amount named in the bond represents a limit, and not a measure, of liability."

The Government has sought in its brief to weaken the effect of Judge McKeehan's reasoning by insisting that he was not entitled to refer to the language of Section 20, Regulations 60, because Form 738 had been authorized, before the promulgation of these regulations, by Treasury Decision 2940. We have heretofore pointed out, however, that the use of Form 738 was expressly authorized under paragraph (c) of Section 20 of Regulations 60, and that the condition of Form 738 expressly covered regulations approved subsequent to the execution of the bond. In fact, in the *Lederer* case, the bond was executed after Regulations 60 had been published. The bond was executed on February 17, 1920.

the regulations were approved January 16, 1920 and published February 1, 1920. Judge McKeehan was, therefore, entirely justified in referring to the language of Regulations 60 in interpreting the condition of the bond. Similarly, in the *Zerbey* case, although the bond was executed on January 23, 1920, the Court is entirely justified in referring to the Regulations in interpreting the bond.

*The Basis of Computing the Amount of the Bond.*

In paragraph (a) of the same section 20 the basis of computation of the bond is stated. It was to be $4.20 per proof gallon on distilled spirits and $100 for each 200 gallons or a fractional part thereof on wine, malt liquors, cider or other liquor. It was provided that in no case should the bond be for less than $1000 nor more than $100,000. It is significant that the $4.20 rate on distilled spirits is exactly the amount of differential tax prescribed by §600 (a) of the Revenue Act of 1918 (40 Stat. 1057, 1105) which was in force prior to the enactment of the National Prohibition Act and which formed the basis of all claims made by the Commissioner up to the time that Attorney General Daugherty submitted his opinion that this tax could be collected only from the distiller (32 Opinions Attorney General, 522), and this court decided in *Lipke* v. *Lederer*, 259 U. S. 557, that the so-called taxes were in reality penalties and could not be collected by distraint proceedings.

This direct relation between the amount of the bond and the taxes which would be imposed under Section 35 Title II of the National Prohibition Act in the event of a violation of the permit is direct evidence of the purpose of the Department to require that the payment of this tax would be assured to the United States by the bond.

*The Department's Request for an Opinion.*

There are further evidences of the purpose of the Treasury Department in requiring Form 738. It will be recalled that

this form was in general use in January 1920 and prior thereto, and that although Regulations 60 provided for a new Form (1408 or 1409), the use of Form 738 continued for some time under the provisions of Section 20 (c) of Regulations 60. Late in 1920 it was represented to the Department that if Form 738 should be revived, and substituted for Form 1408, the premiums exacted by surety companies would be reduced, and accordingly the Department inquired of the Attorney General whether Form 738, on which there were many bonds outstanding, was adequate to insure the collection of taxes and penalties. In the inquiry addressed to the Attorney General it was stated by the Treasury that it was not deemed important that the bond should insure the payment of fines because the interests of the United States in this regard were sufficiently protected by the Courts. The primary interest of the Department as disclosed by this request for an opinion was to obtain adequate assurance that taxes and penalties would be paid. The matter of fines and other punishment for violations it was content to leave to the ordinary processes of courts. The scope and purpose of the Department's inquiry appears in an opinion rendered by the Attorney General in 32 Opinions Attorney General, 365.

*The Departmental Construction in Actual Practice.*

Furthermore, for more than a year after the Act became operative the Commissioner construed Form 738 to be a damage bond. For more than a year all claims presented to the National Surety Company arising from Form 738 were claims for damages. A typical letter, dated November 12, 1920, discloses clearly the attitude of the Department in this respect. It was addressed to the Collector at Brooklyn by D. S. Bliss, Assistant Prohibition Commissioner, concerning a claim on the bond of the Champion Drug Company of Brooklyn. The following extract will be sufficient:

> "In reply you are advised that you may inform the National Surety Company that the Government does not desire it to pay $50,000, which is the amount of the penal sum of the bond, but it desires only $17,794.10, which is the sum of the liability of the defending company and the bond is submitted to indemnify the Government for such liability."

In similar letters received from the Department and from Collectors of Internal Revenue the National Surety Company received unmistakable evidence of the construction placed on these bonds by the administrative authorities responsible for their issuance. This administrative construction under settled principles, is "entitled to respectful consideration." *Smythe* v. *Fiske,* 23 Wall. 382. It is of greater significance here because it indicates the administrative purpose, which directly aids the construction of the bond.

*The Government's Contention Involves a Double Punishment —No Such Purpose Was Contemplated.*

Returning now to the first sentence quoted from Section 20 of Regulations 60 in which it is stated that the bond was to be taken to insure compliance with the provisions of the Act and its regulations *as well as* to cover any taxes and penalties which might be imposed, it remains to be pointed out that this provision could not contemplate a forfeiture bond. Taxes and penalties which might be imposed under the Internal Revenue Laws would be imposed for violations of the National Prohibition Act under Section 35, Title II of that Act. They are in effect, as this court held in *Lipke* v. *Lederer,* 259 U. S. 557 in the nature of fines and penalties rather than in the nature of taxes.

Let it be assumed that a permittee violated his permit and became subject to the double tax imposed by Section 35, Title II, together with the additional penalty imposed by the same section. A tax and penalty are assessed, the permittee resists the assessment, suit is brought by the United States,

and the case is settled, in accordance with the usual departmental policy. Is it to be asserted by the Government that this permittee could be compelled to forfeit $100,000, in addition to the settlement amount which he has paid in full discharge of any liability resulting from his violation of the law? This Court has expressly held that such a position is untenable.

In *United States* v. *Choteau*, 102 U. S. 603, an action was brought against the principal and sureties upon a distiller's bond executed under Section 3260 Revised Statutes. The bond was conditioned among other things that the principal "shall in all respects faithfully comply with all the provisions of law in relation to the duties and business of distillers, and shall pay all penalties incurred or fines imposed on him for a violation of any of the said provisions." The complaint of the United States alleged that the distiller had committed various breaches, among others, that he had removed spirits produced at his distillery without having first paid the internal revenue tax imposed thereon and thereby incurred a penalty of $2,800, which sum he refused to pay. The defense was that he had already been indicted in a United States Court for this very act and that the prosecution had been dropped upon the payment by him of $1,000 by way of settlement. He insisted that this payment had purged the guilt of his violation and therefore that no further claim could be made by the United States on his bond. This Court sustained the defendant's contention, Mr. Justice Field saying at page 611:

> "The Government through its appropriate officers has indicated, under the authority of an Act of Congress, the punishment with which it will be satisfied. The offending party has responded to the indication and satisfied the Government. It would, therefore, be at variance with right and justice to exact in a new form of action the same penalty."

And Mr. Justice Field quoted approvingly from Mr. Justice Miller in *Ex parte Lange*, 18 Wall., 163, 168:

> "If there is anything settled in the jurisprudence of England and America, it is that no man can be twice lawfully punished for the same offense. And though there have been nice questions in the application of this rule to cases in which the act charged was such as to come within the definition of more than one statutory offense, or to bring the party within the jurisdiction of more than one court, there has never been any doubt of its entire and complete protection of the party when a second punishment is proposed in the same court, on the same facts, for the same statutory offence."

So here, if the Government has indicated what penalty it will impose for a violation, and has imposed a tax, or other penalty or fine, the liability on the bond must be limited to a satisfaction of this sum. Yet if the bond were truly a forfeiture bond, such limitation would not follow, and the Government would be free to exact its second punishment for the same offense.

It is submitted that in Regulations 60, Section 20, the Government has indicated that it proposes to assure to itself the payment of taxes and penalties. If these are assured by a bond in Form 738, as the Government intended, it is not open to the Government to argue that Bond Form 738 includes a second and additional punishment.

*Zerbey Has Already Been Punished.*

The application of this illustration to the present case is patent. Zerbey was indicted in Cincinnati for conspiracy to violate Section 3 of Title II of the National Prohibition Act. The violations alleged were the transportation between May 14 and May 20, 1920, across the State of Ohio of liquor withdrawn for non-beverage purposes but diverted for beverage purposes and the sale in Cleveland for such purposes on or about May 20, 1920. These dates, it will be noted, are included within the period of the alleged violations in the present case. (See Certificate, p. 3.)

He pleaded guilty, was fined $1000. and sentenced to serve five months in jail. After serving three months, he was pardoned by President Harding. Subsequently the Government sued out an attachment against his property in the United States District Court for the Middle District of Pennsylvania to cover taxes and penalties alleged to be due and unpaid as the result of violations of the National Prohibition Act. Following *Lipke* v. *Lederer*, the attachment and tax lien were dissolved on a motion to quash, under an opinion rendered by District Judge Witmer on June 23, 1922 (unreported).

Yet in the present proceeding the United States seeks to recover $100,000 as a forfeiture sum for the *very violations* with respect to which it has already pursued Zerbey under other provisions of the Act. The decision of this court in *United States* v. *Chotcau* makes the position of the Government untenable.

The double character of the punishment thus imposed is displayed in the Treasury Department's letters to Zerbey and to the National Surety Company making the demand on which this case is based. These letters are set forth in the footnote.*

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*TREASURY DEPARTMENT
WASHINGTON

[Office symbols
omitted]

July 30, 1921

Mr. John E. Zerbey, Sr.,
Summit Hill, Pa.

Sir:

Under date of January 23, 1920, a permit covering the right to sell intoxicating liquors at wholesale was issued in your favor and a bond in the amount of $100,000 was given by you at that time to secure faithful compliance with the provisions of this permit and the National Prohibition Act and regulations promulgated thereunder.

Under the authority given you by this office you withdrew large quantities of liquor and the record discloses same was diverted to beverage purposes with your knowledge and consent and you were convicted on the charge of conspiracy to violate the liquor laws and served a sentence in the jail at Cincinnati.

Inasmuch as you wilfully violated the terms of the non beverage permit issued to you, your bond in the amount of $100,000 is subject to

The Commissioner sought to impose the same double punishment in *United States* v. *Fidelity & Guaranty Co.*, 1 Fed. (2d) 335 (W. D. N. Y. 1924). Judge Hazel thus described the position of the Government (p. 336):

> "In this action against the corporate surety the government seeks to recover $10,000, the full penalty of the bond, claiming that upon breach thereof the entire amount became due, regardless of the payment of the fine imposed by the court upon the principals for their violation."

The complaint was dismissed.

Similarly in *United States* v. *Carrsow and National Surety Co.*, decided by Judge Dietrich in the United States District Court for the District of Idaho (unreported—opinion printed in Government's brief, p. 68), the record shows that for the alleged violations made the basis of the claim on the bond there had already been a criminal charge and conviction.

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forfeiture and you are hereby notified that payment of the full amount into the Treasury is demanded within ten days from the receipt of this communication. In the event of refusal on your part to make settlement as herein stated, the National Surety Company, your bondsmen, will be notified of its liability and in default of payment by it the matter will be referred to the Attorney-General with the request that suit be instituted for recovery of the entire amount which is due.

An immediate expression is desired as to your contemplated action in the light of the instructions herein set forth.

Respectfully,

D. H. BLAIR
Commissioner

as

TREASURY DEPARTMENT
WASHINGTON

[Office symbols omitted]

August 15, 1921

The National Surety Company,
New York, N. Y.

Gentlemen:

Under date of January 23, 1920, your company furnished a supporting bond in the amount of $100,000 in favor of John E. Zerbey, Sr., of

## C. The Purpose of Congress in requiring a bond from permittees was indemnity only.

A consideration of the provision of the National Prohibition Act authorizing the bonds here involved indicates likewise an intention on the part of Congress to require indemnity only. Section 6 of Title II of the Act contains the following authorizing provision (41 Stat. 310):

> "Before any permit is granted the Commissioner may require a bond in such form and amount as he may prescribe to insure compliance with the terms of the permit and the provisions of this Title."

There is nothing in this language authorizing the Commissioner to impose a forfeiture bond to aid the United States generally in enforcing its law. All that the Act contemplated was "compliance with the terms of the permit and the provisions of this Title." The later phrase is to be construed as relating to such provisions as concern the terms of the permit and the circumstances surrounding its issuance. The sentence quoted left it open to the Commisioner to prescribe

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Summit Hill, Pa., holder of a permit to sell intoxicating liquors for nonbeverage purposes under the rules and regulations of this Bureau.

Under the authority given Mr. Zerbey by the permit held, a considerable quantity of liquor was withdrawn but diverted to beverage purposes in a manner inconsistent with the terms of said permit and further disclosing a flagrant violation of the National Prohibition Act. Because of the unlawful diversion of these liquors to beverage purposes Mr. Zerbey has been tried and convicted in the Federal courts for conspiracy to violate the Prohibition laws and he served a sentence in the jail at Cincinnati, Ohio.

In accordance with the ruling of the Attorney-General, Mr. Zerbey's bond was declared forfeited and notice for payment of the amount provided in same was given under date of July 30, 1921. On that occasion Mr. Zerbey was informed that in default of settlement of the full liability under the bond by him as principal within ten days' notice, demand would be made upon the National Surety Company and in default of payment by it the matter would be referred to the Department of Justice with the request that suit be entered for recovery of the entire amount set forth in the bond which your company furnished.

Mr. Zerbey has failed to make settlement of the amount due within the time stipulated and informally, through his attorney, he has stated

the form and amount of the bond, but confined the substance of the bond's obligation to the purpose stated in the Act. That purpose is not to be gathered from the words of this Section alone but as well from a reading of the Act as a whole.

As this Court has said, the statute is a "comprehensive" one. *United States* v. *Yuginovich*, 256 U. S. 450, 460. It is also a "highly penal" statute. *Fontenot* v. *Accardo,* 278 Fed. 871, 873 (C. C. A. 5th, 1922); *Dukich* v. *Blair,* 3 F. (2d) 302, 304 (E. D. Wash. 1925). The provisions of Sections 29 and 35 of Title II are ample to cover all violations for which punishment is to be imposed. These sections are specific; they prescribe specific punishments for specific violations. Section 29 contains the following provision applying to the violation of a permit (41 Stat. 316):

> "Any person violating the provisions of any permit, or who makes any false record * * *, or violates any of the provisions of this title, for which a special penalty is not prescribed, shall be fined for a first offense not more than $500; for a second," etc.

It is not lightly to be assumed that broad language elsewhere in the Act is intended in blanket fashion to cover the same violations which in Sections 29 and 35 are made definitely punishable in definite amounts. Such an interpretation as-

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it to be his intention to refuse settlement as requested in office letter of above date.

Inasmuch as the principal of this bond has failed to make settlement as requested the Department looks to your Company for payment of the full amount of this bond within ten days from the receipt of this communication.

In the event of your failure to satisfy this liability within the time stated, the matter will be taken up with the Department of Justice with the request that the United States Attorney enter suit at once to protect the interests of the Government by securing a judgment in the amount of $100,000 due and unpaid.

Respectfully,

D. H. Blair,
Commissioner.

sumes an intention on the part of Congress to impose two punishments for the same offense.

That such an interpretation may not be maintained was pointed out in *United States* v. *1412 Barrels of Distilled Spirits,* Fed. Cas. No. 15960, where the court said of a similar suggestion:

> "Now to suppose that Congress by the 96th Section (Act of July 20, 1868—15 Stat. 143) means to declare that those who violate the law in any particular should, notwithstanding the specified penalty prescribed in any section, forfeit also all spirits owned by them (as provided in §96), is to impute to Congress little less than an absurdity."

Compare also the vigorous statement of Mr. Justice Miller in *Ex parte Lange,* 18 Wall. 163, 168:

> "If there is anything settled * * * maxims of the common law" (quoted, *supra*, p. 34).

Nor is such broad language to be read as authorizing the Commissioner to fix a forfeiture sum in the nature of a supplementary fine where all the acts for which he imposes the forfeiture have already been made punishable by other provisions.

*The Prior Use of Form 738 Under Three Statutes.*

It will be recalled that Form 738 was authorized in Treasury Decision 2940 to carry into effect the provisions of three statutes in force prior to the National Prohibition Act as well as that Act. In the language of none of these statutes does it appear that the bond contemplated was to be a forfeiture bond. In Section 15 of the Food Control Act of August 10, 1917 (40 Stat. 282), the bond is referred to in the following language:

> "That from and after thirty days from the date of the approval of this Act no foods, fruits, food materials or feeds shall be used in the production of dis-

> tilled spirits for beverage purposes: *Provided,* that under such rules, regulations and bonds as the President may prescribe, such materials may be used in the production of distilled spirits exclusively for other than beverage purposes. * * * "

That the bond contemplated by this language was not to be the means of punishment for violations of the Act is evident from subsequent language in the same Section in which definite fines and imprisonment are imposed for violations of the Act or of any regulations issued thereunder.

Likewise the War Prohibition Act of November 21, 1918, Fourth Section (40 Stat. 1046) contained no provision authorizing the requirement of a forfeiture bond. Indeed this Act does not mention any bond, but provides broadly:

> "The Commissioner of Internal Revenue is hereby authorized and directed to prescribe rules and regulations, subject to the approval of the Secretary of the Treasury, in regard to the manufacture and sale of distilled spirits and removal of distilled spirits held in bond after June thirtieth, nineteen hundred nineteen until this Act shall cease to operate, for other than beverage purposes. * * * "

As in the previous Act, punishment by fine or imprisonment is definitely imposed for the violation of any provision of the Act or its regulations. It is submitted that there is nothing in this statute indicating an intention on the part of Congress to require a forfeiture bond.

The third Statute was the Revenue Act of 1918, approved February 24, 1919 (40 Stat. 1105). The language of this statute likewise does not provide that the bonds therein authorized are to be forfeitable in their full amount for any violation of the Act. Section 602 is the section pursuant to which Form 738 was authorized. The language of that section reads:

> "The Commissioner, with the approval of the Secretary, is hereby empowered to prescribe all necessary

> regulations relating to the drawing off, transferring, gauging, storing and transporting of such spirits; the records to be kept and returns to be made; the size and kind of packages and tanks to be used; the marking, etc., of such packages and tanks; the kinds of stamps, if any, to be used; and the time and manner of paying the tax; the kind of bond and the penal sum of same."

In these three statutes bond Form 738 had its source. In not one of them is there any indication that Congress required or authorized a forfeiture bond. In each of them there is a comprehensive penal provision imposing fines and imprisonment for violations of the Act and its regulations. Under none of them, so far as the National Surety Company knows, was any attempt ever made by the Treasury Department to enforce a forfeiture of the full amount of a Form 738 Bond.

It is important in this connection to advert to the cases relied upon by the Government, in which it appears without exception that the statute authorizing the bond either prescribed in definite amount the sum thereof and the condition therein or made it plain in unmistakable language that the bo was required merely as a means of inflicting a punishment. In other words the statute imposed its punishment indirectly by the device of a bond. In the National Prohibition Act punishment is imposed directly by Sections 29 and 35.

Thus in *Clark* v. *Barnard*, 108 U. S. 436 and in *United States* v. *Dieckeroff*, 202 U. S. 302, the exact sum of the bond was set forth in the statute. In *Clark* v. *Barnard*, Mr. Justice Matthews said at page 461:

> "In the second place, we think, that the sum named in the *statute* is imposed by it as a *statutory* penalty for the non performance of a *statutory* duty."

In *United States* v. *Alcorn*, 145 Fed. 995, the statute involved (18 Stat. 235) expressly stated that upon the failure

of the condition, the principal and his sureties would be liable for the amount of the bond as *liquidated* damages.

In *United States* v. *Montell,* 26 Fed. Cas. 1293, Chief Justice Taney said (p. 1294):

> "Yet this sum was, in truth, forfeited by Montell, by reason of his violation of a duty imposed by the Act of Congress; it was a *specific* penalty upon the owner and master for the commission of a *particular offense* against the policy of the law."

These cases leave no doubt that Congress may and frequently does seek to enforce its laws by exacting punishment through the medium of the forfeiture of a definite sum fixed in a bond. But no such method of enforcement is indicated in Section 6 of Title II, of the National Prohibition Act. Instead there is merely the broad provision that the Commissioner may require a suitable bond before he issues a permit to do acts which without the permit would be violations.

*Other Sections of the National Prohibition Act Expressly Require a Forfeiture Bond.*

The importance of the failure of Congress to prescribe the forfeiture of the bond authorized under Sec. 6, Title II, is emphasized by the express statement in another section of the Act that the bond required was to be a forfeiture bond, or one for liquidated damages. Thus in the second paragraph, Sec. 4 of Title I, the following language is used in connection with the bond required from a party who had been charged with the maintenance of a nuisance (41 Stat. 306):

> "Whenever an action to enjoin a nuisance shall have been brought pursuant to the provisions of this Act, if the owner, lessee, tenant, or occupant appears and pays all costs of the proceedings and files a bond, with sureties to be approved by the clerk of the court in which the action is brought, in the liquidated sum of not less than $500 nor more than $1,000, conditioned that he will immediately abate said nuisance

> and prevent the same from being established or kept therein a period of one year thereafter, or during the war and period of demobilization, the court, or in vacation the judge, may, if satisfied of his good faith, direct by appropriate order that the property, if already closed or held under the order of abatement, be delivered to said owner, and said order of abatement canceled, so far as the same may relate to said property; or if said bond be given and costs therein paid before judgment on an order of abatement, the action shall be thereby abated as to said room, house, building, boat, vehicle, structure, or place only."

Again in Section 22 of Title II the nuisance bond is required to be "in the penal and liquidated sum of not less than $500 nor more than $1,000." (41 Stat. 314).

Likewise in Section 26, Title II, prescribing the bond to be given by a person charged with unlawful transportation, to cover the return of a vehicle by which the transportation had been accomplished, the statutory requirement reads (41 Stat. 315):

> "The said vehicle or conveyance shall be returned to the owner upon execution by him of a good and valid bond, with sufficient surety, in a sum double the value of the property, which said bond shall be approved by said officer and shall be conditioned to return said property to the custody of said officer on the day of trial to abide the judgment of the court."

A reading of this language leaves little doubt but that the bond prescribed was to be a forfeiture bond. No such plain language occurs in Sec. 6 of Title II. The clear expression of the Congressional intention to require a forfeiture bond in other sections of the Act leaves little doubt that the omission to prescribe a forfeiture bond in Sec. 6 was intentional and should be given appropriate effect in the interpretation of the condition of the bond. The imposition of a penalty of this sort must be authorized in clear language. The lan-

guage must be sufficiently clear to make it fair to say that Congress itself is imposing the penalty. It is submitted that the language in Sec. 6 falls far short of this requirement.

For failure to comply with the terms of the permit liabilities may arise in favor of the United States. But in view of the comprehensive character of the statute, and especially in view of the definite provisions for punishment in Sections 29 and 35 of Title 11, and in view of the requirement that a forfeiture bond must be so unmistakably authorized that a court fairly may say that the statute itself is imposing the penalty, surely the purpose of Congress in enacting Section 6 was not to require a forfeiture bond.

*A penal bond is to be construed strictly.*

One further aid in construction must be mentioned—strict construction of a punitive bond. The argument was so tersely put by Judge McKeehan in Case No. 120 below that it may be quoted here without further elaboration. 4 Fed. (2d) 418, 420:

> "Punitive bonds of this character, together with the statutory provisions and regulations under which they are required to be executed, should be construed, like tax laws, not according to what seems to be the probable broad, general intention of the government, but strictly in accordance with their provisions, and, where reasonable doubts exist, they should be resolved in favor of the obligor upon whom the punishment is sought to be imposed."

To sum up this point, it may be noted that the language of Form 738 covering as it does many diverse acts, the evident purpose of the Commissioner and of the Department to insure to the United States indemnity only, and the purpose of Congress as disclosed in Section 6 and in the Act as a whole—in short the essential factors to be considered in construing this bond—all point toward indemnity only, not to forfeiture.

## POINT II.

### Revised Statutes Section 961 prevents the recovery of the full amount under this bond.

Section 961 of the Revised Statutes was the original Section 26 of the Judiciary Act of 1789, and without amendment has remained in our statutes ever since. It provides:

> "In all suits brought to recover the forfeiture annexed to any articles of agreement, covenant, bond, or other specialty, where the forfeiture, breach, or non-performance appears by the default or confession of the defendant, or upon demurrer, the court shall render judgment for the plaintiff to recover so much as is due according to equity. And when the sum for which judgment should be rendered is uncertain, it shall, if either of the parties request it, be assessed by a jury."

It may be stated generally that this section will bar the recovery of a full amount upon a bond unless the plaintiff is entitled "according to equity" to such recovery, unless the language of the bond or the authorizing statute is so clear that it fairly may be said that the parties have consented to a forfeiture with the statute in mind. Thus, Chief Justice White in *Sun Publishing Association* v. *Moore*, 183 U. S. 642, 662, stated that there would be no statutory relief against "the *plainly expressed* will of the parties." And Mr. Justice Day in *U. S.* v. *Dieckerhoff*, 202 U. S. 302, 312, pointed out that where it was the intention of Congress "to provide a *specific* penalty" for a violation of the condition of the bond, then neither a court of equity nor a federal court applying Section 961 could interfere to give relief. In *United States* v. *Alcorn*, 145 Fed. 995, 998 (C. C. W. D. Mo. 1906) the court said there would be no general equitable relief if "it *clearly* appears the amount fixed in the bond *was agreed to* * * * as liquidated damages."

It appears from the above statements that Section 961 will operate unless the Congressional purpose is clear or the agreement of the parties is "plainly expressed" that the full amount of the bond is to be forfeited.

Section 6 of Title II of the National Prohibition Act does not disclose clearly the Congressional purpose of imposing a forfeiture. On the contrary, as has already been argued, this section when read in the light of other parts of the Act, displays the opposite intention. Nor does the language of the bond "plainly express" an agreement of the parties contemplating forfeiture. The clear language necessary to remove the effect of Section 961 is not present either in the statute or the bond. Under these circumstances the statute should be given its effect.

*United States* v. *Abeel*, 174 Fed. 12, 21 (5th C. C. A. 1909);
*In re Appel*, 163 Fed. 1002, 1004 (1st C. C. A. 1908).

## POINT III.

### If Form 738 is held to be a forfeiture bond on its face, it represents an excess of power on the part of the Commissioner which prevents its enforcement.

It will not be denied that the Commissioner cannot by his order subject a permittee to the possibility of additional punishment for the violation of an Act of Congress by the mere imposition of an administrative requirement. Conceding that under the line of cases illustrated by *Field* v. *Clark*, 143 U. S. 649; *Buttfield* v. *Stranahan*, 192 U. S. 470; *Williamson* v. *United States*, 207 U. S. 425; *United States* v. *Grimaud*, 220 U. S. 506, and kindred cases dealing with the power of administrative officers to "fill up the gaps" and settle the details necessary to an adequate enforcement of

Acts of Congress, the Commissioner of Internal Revenue can go far in prescribing bonds and other appropriate incidentals to the issuance of permits, it nevertheless is clear that he may not add new punishments for acts as to which Congress has itself imposed specific penalties. To do so is to exercise legislative power of the clearest kind. The Act contains no appropriate words of delegation, to confer such power.

If the form of the bond which he has authorized has the effect of subjecting the principal to such additional punishment, the Commissioner has exceeded his authority and the bond may not be enforced.

The significance of this argument is illustrated by the fact that in the line of cases on which the Government relies this Court has always been astute to discover in the basic statute an indication that Congress was imposing the liability on the bond as its method of punishing a violation of its law. Without such indication in the statute, the Commissioner would be without power to prescribe a punishment. For this reason the statute (and this refers to the statute as a whole and not to the particular authorizing provision) must be read with and into the bond. Chief Justice Taney was careful to do this in *United States* v. *Montell*. Mr. Justice Matthews did so in *Clark* v. *Barnard*. Mr. Justice Day did so in *U. S.* v. *Dieckeroff*.

The application to the present case is apparent. The "comprehensive statute" imposes penalties of many kinds for violations which Congress sought to punish. In a broad provision in another section of the Act, not dealing with the violations of the law, the Commissioner is authorized to require a bond to insure compliance with the terms of the permit and the provisions of Title II. There is nothing in this language empowering the Commissioner to exercise the legislative power of prescribing added punishment.

Pursuant to this provision, he undertakes to require a bond which on its face (it may be conceded solely for this ar-

gument) calls for a forfeiture of the full amount for any violation of any requirement of the Act or its Regulations. It will not seriously be contended that the Commissioner could establish the right of the United States under this bond until there has been a conviction or other "evidence of crime" upon which he would make his claim. *Lipke* v. *Lederer,* 259 U. S. 557, 562; *Regal Drug Co.* v. *Wardell,* 260 U. S. 386, 392; *Dukich* v. *Blair,* 3 F. (2d) 302, 303 (E. D. Washington, 1925). Accompanying the conviction some appropriate punishment would be imposed, in most cases a fine. The effect of enforcing the bond is at once to impose an additional fine for the identical offense for which Congress and its appropriate law officers have exacted the full punishment desired, and entirely without the requisite clear legislative authorization behind the Commissioner.

The mere statement of this situation would seem to be convincing that the Commissioner so imposing a forfeiture bond would be acting in excess of his authority. The Commissioner acting under the guise of the authority of an act of Congress would be attempting to do what a Federal court said when it was argued that Congress had done it would be imputing to Congress an absurdity. *United States* v. *1412 Barrels, supra.* He would be doing what Mr. Justice Miller in *Ex parte Lange,* 18 Wall. 163, 168, said was contrary to the most settled principle in the common law. But more serious, he would be legislating without any delegation of authority so to do.

This is not filling up the details or supplying appropriate administrative measures to secure the enforcement of the Congressional intention. It is superimposing upon the individuals an additional fine and penalty which Congress has not seen fit to impose and which it has not empowered the Commissioner to impose. When the Commissioner purports to inflict an additional penalty of this sort, in the absence of very plain statutory authority, he has exceeded his powers.

A somewhat related question is now on the Docket of this Court in No. 418* on direct appeal from the United States District Court for the Eastern District of Washington. *Dukich* v. *Blair,* 3 F. (2d) 302 (1925). That court has held that Section thirty-five of the National Prohibition Act as amended by Section five of the Willis-Campbell Act (42 Stat. 222, 223) is unconstitutional in so far as it purports to empower the Commissioner to impose a tax (held by this Court in reality to be a penalty) which may be collected by distraint proceedings for a violation of the Act. In the opinion of the district judge, reliance is placed chiefly on this Court's statement in *Lipke* v. *Lederer,* 259 U. S. 557, 562.

> "And certainly we cannot conclude, in the absence of language admitting of no other construction, that Congress intended that penalties for crime should be enforced through the secret findings and summary action of executive officers. The guaranties of due process of law and trial by jury are not to be forgotten or disregarded."

The opinion of Mr. Justice McKenna to the same effect in *Regal Drug Company* v. *Wardell,* 260 U. S., 386, 391 was also relied upon.

> "Describing the power, we said, that the collector was undertaking to punish Lipke 'by fine and penalty for an alleged criminal offense without hearing, information, indictment or trial by jury, contrary to the federal Constitution.' And we said further that, if the 'section has the meaning ascribed to it by the defendant [the collector], it is unconstitutional.' "

In further elaboration of his opinion District Judge Webster said, 3 F. (2nd) 306, 308:

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*Advanced for argument on April 12, 1926, together with *Seligman* v. *Bowers,* 4 Fed. (2d) 1011.

> "In view of the analysis of section 35, as supplemented by section 5 of the Willis-Campbell Act, already made, it seems too clear for serious debate that a legislative attempt has been made to lodge in an administrative official the power to receive evidence to establish the commission of crime, and, in the event guilt is proven to his satisfaction, to inflict upon the culprit, solely as a matter of punishment, the definite penalty prescribed, and to collect the amount of the fine imposed by distraint as for taxes, in the true meaning of the term. In my opinion, such legislation is beyond the sphere of constitutional enactment. It is repugnant to and violative of the guaranties of both due process of law and the right of trial by jury. It is inconsistent with the genius of our government and is wholly out of harmony with the spirit of our institutions. It smacks of the Star Chamber, and cannot be permitted to stand."

The theory of this opinion is that it is unconstitutional to empower an administrative officer to adjudicate the facts which will determine whether or not the crime has been committed and to impose the penalty therefor. After carefully considering the extent to which the case of *Oceanic Navigation Co.* v. *Stranahan*, 214 U. S. 320 goes, the District Court was of the opinion that nothing in that decision sanctioned the grant of power to the Commissioner in Section 35. The same observations may be made with respect to the provisions of Section 6 authorizing a bond. If the Commissioner cannot constitutionally assess and collect a tax upon what he charges amounts to a violation of the Act, no more can he *ex mero motu* demand the forfeiture of $100,000 upon the same charge.

## Conclusion.

It is respectfully submitted that the questions certified in No. 790 should be answered as follows:

To the first question: *No.*
To the second question: *Yes.*

Respectfully submitted,

RALPH W. RYMER,
*Attorney for National Surety Company.*

JOHN W. DAVIS,
JAMES M. NICELY,
*Of Counsel.*

## APPENDIX.

*Appearances.*

IN THE

DISTRICT COURT OF THE UNITED STATES

IN AND FOR THE MIDDLE DISTRICT OF PENNSYLVANIA.

| | |
|---|---|
| UNITED STATES OF AMERICA, Plaintiff, vs. JOHN E. ZERBEY AND NATIONAL SURETY COMPANY, Defendants. | No. 1496, January Term, 1923. On Affidavits of Defense Raising Questions of Law. |

Andrew B. Dunsmore, Esq.,
United States Attorney, Wellsboro, Pa.
Hon. A. A. Vosburg,
Asst. United States Attorney, Scranton, Pa.
Herman F. Reich, Esq.,
Asst. United States Attorney, Sunbury, Pa.
Llewellyn Jordan, Esq.,
Special Asst. to the Attorney General, Washington, D. C.
Attorneys for the Plaintiff.

Ben Branch, Esq., Mauch Chunk, Penna.
O'Brien & Kelly, Esqs., Scranton, Penna.
Attorneys for John E. Zerbey, Defendant.

Ralph W. Rymer, Esq., Scranton, Penna.
Attorney for National Surety Company, Defendant.

*Opinion.*

**Memoranda and Order.**

And now, December 26, 1924, this action has been brought to recover the penal amount of a bond (Form 738) for permit to use or sell distilled spirits and wines for other than beverage purposes, given in the sum of One Hundred Thousand Dollars ($100,000.00) by the defendant, John E. Zerbey, as principal and the National Surety Company as surety, to the United States of America, conditioned that the "principal shall fully and faithfully comply with all the requirements of the laws of the United States now or hereafter enacted and regulations issued pursuant thereto respecting the sale or use of distilled spirits and wines for other than beverage purposes." Recovery of the penal sum named is sought on the ground that the conditions of the bond, it is alleged, were breached by the principal, charging him with having failed and neglected to comply with the requirements of the laws of the United States and the regulations issued in pursuance thereof, respecting the sale of distilled spirits for other than beverage purposes, and with further having unlawfully sold and disposed of large quantities of distilled spirits for beverage purposes and having diverted large quantities of said distilled spirits for other than nonbeverage purposes, in violation of the terms of the permit granted to him by the Federal Prohibition Commissioner, acting under and by virtue of the authority of the Commissioner of Internal Revenue.

The defendants deny liability, alleging as a legal proposition, that on the breach of the conditions of the bond, the plaintiff cannot recover the entire penal sum, without reference to the damages sustained, but can only recover the amount of the pecuniary loss, and as no pecuniary loss or damage is alleged to have been suffered by reason of the breaches of the conditions, plaintiff's actions cannot be sustained. The legal question presented is whether the breach

of the conditions of the bond renders defendant obligors liable for the full amount of its penal sum, or whether recovery shall be limited to actual damages sustained by the obligee. If the latter, the action cannot be sustained under the pleadings for the reason set forth by defendants. If however, the bond is a forfeiture bond and the full penalty is incurred upon breach of its conditions, the action may be sustained, provided the facts pertaining to the alleged breach are made to appear to the satisfaction of the court and jury.

The question has been variously answered and is not free from doubt, however, I am persuaded to accept as a guide to my conclusion, the well considered opinion of the Circuit Court in United States vs. Wandmaker, 292 Fed. 24; which was followed by Judge McKeehan in Francis O'Kane vs. Ephraim Lederer, Collector, decided about August 12th, 1923, in the District Court for the Eastern District of Pennsylvania (unreported to date), and United States vs. United States Fidelity and Guaranty Company, 1 Fed. (2nd.) 335, and by Judge Dietrich in United States vs. The National Surety Company, et. al., decided February 4th, 1924 (unreported to date), in which Judge Dietrich also cites and follows the O'Kane vs. Lederer case, supra.

Judgment absolute will be entered dismissing the action. To which an exception is noted for the plaintiff.

By the Court,

CHARLES B. WITMER,
District Judge.

12-26-24.

Filed Dec. 29, 1924.

## Surety Bond Form 738.

KNOW ALL MEN BY THESE PRESENTS, That .....
of ..... as principal, and .....
of .....
as surety, are held and firmly bound unto the United States of America in the sum of .....
dollars, lawful money of the United States, for the payment whereof to the United States we bind ourselves, our heirs, executors, administrators, successors or assigns, jointly and severally, firmly by these presents.

WHEREAS the above-abounden principal has made application for a permit to *use and sell distilled spirits and wines* [1] for other than beverage purposes at .....
.....
in the ..... Collection District of .....

NOW, THEREFORE, the condition of this obligation is such that if the said principal shall fully and faithfully comply with all the requirements of the laws of the United States now or hereafter enacted and regulations issued pursuant thereto, respecting the *sale or use of distilled spirits and wines* [1] for other than beverage purposes, then this obligation to be void; otherwise to remain in full force and virtue.

Witness our hands and seals this....day of....., 19....

Signed, sealed, and delivered in the presence of—

..... .....[SEAL]
..... .....[SEAL]
..... .....[SEAL]
..... .....[SEAL]

[1] Strike out words not applicable.

## Collateral Bond Form 738A.

KNOW ALL MEN BY THESE PRESENTS, That .....
of ..... as principal, and .....
of .....
as surety, are held and firmly bound unto the United States of America in the sum of .....
dollars, lawful money of the United States, for the payment whereof to the United States we bind ourselves, our heirs, executors, administrators, successors or assigns, jointly and severally, firmly by these presents.

WHEREAS the above-bounden principal has made application for a permit to *use and sell distilled spirits and wines* for other than beverages purposes at .....
.....
in the ..... Collection District of .....

NOW, THEREFORE, the condition of this obligation is such that if the said principal shall fully and faithfully comply with all the requirements of the laws of the United States now or hereafter enacted and regulations issued pursuant thereto, respecting the sale or use of distilled spirits and wines for other than beverage purposes, then this obligation to be void; otherwise to remain in full force and virtue, and the said principal expressly agrees that the said bonds so deposited may be sold at public or private sale with or without notice of said sale and without notice of any character to the principal, and the proceeds applied to the payment of any internal revenue taxes, interest, and penalties which may be due, and in satisfaction of any liabilities incurred hereunder and the expenses of such sale, if any and the residue, if any, paid to the said principal.

WITNESS our hands and seals this....day of....., 19....
Signed, sealed and delivered in the presence of—

..... .....[SEAL]
..... .....[SEAL]
..... .....[SEAL]
..... .....[SEAL]

## Surety Bond Form 1408.

KNOW ALL MEN BY THESE PRESENTS, That .....
.....
of ..... as principal, and.....
.....
of .....
as surety, are held and firmly bound unto the United States of America in the sum of .....
dollars, lawful money of the United States, for the payment whereof to the United States we bind ourselves, our heirs, executors, administrators, successors, or assigns, jointly and severally, firmly by these presents.

WHEREAS, the above-bounden principal has made application for the issuance of a permit under the National Prohibition Act and regulations issued thereunder, and whereas, it is intended by this instrument to also insure compliance with Internal Revenue Laws and regulations issued thereunder.

NOW, THEREFORE, the condition of this obligation is such that if there be no material false statement in the application for such permit, and the said principal shall not violate the terms of such permit issued to him by the Commissioner of Internal Revenue, or any person authorized by him to issue permits, on such application or shall not violate any of the provisions of the National Prohibition Act and regulations promulgated thereunder as now or hereafter provided, and all other laws of the United States now or hereafter enacted respecting distilled spirits, fermented liquors, wines, or other intoxicating liquors, and will pay all taxes, assessments, fines, and penalties incurred or imposed upon him by law, then this obligation to be void, otherwise to remain in full force and effect.

WITNESS our hands and seals this....day of ....., A. D. 192....

Signed, sealed and delivered in the presence of—

| | |
|---|---|
| ..... | .....[SEAL] |
| ..... | .....[SEAL] |
| ..... | .....[SEAL] |
| ..... | .....[SEAL] |

Approved:

.....
Director.

FILED
FEB 24 1926
WM. R. STANSBURY
CLERK

IN THE

# SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1925.

---

## No. 120.

---

EPHRAIM LEDERER, FORMERLY COLLECTOR, ETC.,

*vs.*

MARY A. McGARVEY, EXECUTRIX, ETC.

---

ON CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

---

## BRIEF ON BEHALF OF MARY A. McGARVEY, EXECUTRIX OF THE ESTATE OF FRANCIS O'KANE, DEFENDANT IN ERROR.

---

FREDERICK W. BREITINGER,
*Attorney for Mary A. McGarvey, Executrix, etc.*

LEVI COOKE,
GEORGE R. BENEMAN,
*Of Counsel.*

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IN THE

# SUPREME COURT OF THE UNITED STATES.

**OCTOBER TERM, 1925.**

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## No. 120.

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EPHRAIM LEDERER, FORMERLY COLLECTOR, ETC.,

*vs.*

MARY A. McGARVEY, EXECUTRIX, ETC.

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ON CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

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## BRIEF ON BEHALF OF MARY A. McGARVEY, EXECUTRIX OF THE ESTATE OF FRANCIS O'KANE, DEFENDANT IN ERROR.

---

### I.

### Statement.

This case comes to this Court by the certificate of the Circuit Court of Appeals for the Third Circuit. A companion case, United States *vs.* John E. Zerbey and National Surety Company, No. 790 of this term, is here on certificate presenting identical questions as herein certified.

## Questions Certified.

The Circuit Court of Appeals desires the instructions of the Supreme Court on the following questions certified:

> "1. Is a bond conditioned upon compliance with the laws of the United States and regulations issued pursuant thereto, respecting the sale or use of distilled spirits and wines for other than beverage purposes, given the United States by one to whom a permit to sell intoxicating liquors for other than beverage purposes has been issued under the provisions of Title II of the national prohibition act and regulations promulgated thereunder, forfeitable upon breach of the condition in the full amount of its penal sum?
>
> "2. Is recovery upon breach of the condition of such a bond given by one holding such a permit limited to actual damages sustained by the United States?"

In other words, where such a bond is given, upon violation, is the full penal sum forfeitable, or is recovery limited to the actual damages sustained? Is the penal sum named therein the measure or simply the limit of liability thereunder?

## Propriety of the Certificate.

The Government in its brief states that there is doubt as to the propriety of the certificate in this case. The Collector of Internal Revenue having pleaded

the alleged forfeited penal sum of the bond as a counterclaim to a suit for recovery of taxes and penalties admittedly refundable to the plaintiff below, sued out his writ of error after judgment for plaintiff.

This case was briefed and argued in the Circuit Court of Appeals and that court, desiring instructions on some of the questions of law involved, certified the questions to this Court for instructions.

It is believed to be the duty of counsel for the defendant in error to brief for this Court the questions specifically submitted to this Court by the certificate, and this brief will therefore be addressed to the questions on the assumption that the certificate is properly here and that any impropriety thereof cannot be assumed by counsel.

## ARGUMENT.

### POINT I.

### Form 738 is an Indemnity Bond and Not a Forfeiture Bond.

#### 1. The Authority for the Bond, and the Form of the Bond

We are dealing with a specific form of bond prescribed by the Commissioner, as required by regulations promulgated under a statute. The meaning and liability of the bond are to be ascertained and determined from the statute, the regulations and the bond itself.

The National Prohibition Act (October 28, 1919, 41 Stat., 305), Title II, Section 6, *inter alia*, provides:

> "The Commissioner (Commissioner of Internal Revenue) may prescribe the form of all permits and applications and the facts to be set forth therein.
>
> "Before any permit is granted, the Commissioner may require a bond in such form and amount as he may prescribe to insure compliance with the terms of the permit and the provisions of this title * * *."

The act therefore simply gives authority to the Commissioner to supply administrative detail to carry out the measure. The "form" and "amount" of the bond may be prescribed by him. That is, the proper phraseology and appropriate penal sum or sums, perhaps on a graduated scale, to carry out the provisions of the law.

No authority is given to the Commissioner to create penalties for a breach of the law. The law itself fixes the penalties for violation.

The Commissioner, pursuant to the authority thus vested in him, prescribed the form and amount of the bond by regulations dated January 16, 1920, published February 1, 1920, and known as "Regulations 60."

Section 20, Article 3, of "Regulations 60" (22 Treasury Decision, Internal Revenue, 65), pursuant to which the bond in this case was given, provides:

> "All persons, desiring to obtain permits provided by these regulations, except as provided below, must at or before the time of filing ap-

plication therefor, file with the Director a bond in duplicate on Form 1408 or Form 1409 to insure compliance with the provisions of this act and of the regulations as well as to cover any taxes and penalties which may be imposed under the Internal Revenue laws. (*Idem*, p. 74.)

"Except where otherwise provided, the basis of the penal sum of such bond will be as follows:

"Four dollars and twenty cents per proof gallon on distilled spirits and $1.00 for each 200 gallons, or fractional part thereof, on wine, malt liquor, cider or other liquor, manufactured or received during the quarterly period of the calendar year plus the quantity in hand at the end of the preceding quarterly period. In no case shall the penal sum of any bond be less than $1,000 nor more than $100,000 * * *." (*Idem*, p. 74).

and Section 21, Regulations 60, provides:

"If bond, Form 1408, is used, it must have a corporate surety * * *. If bond, Form 1409, is used, United States Government bonds in a face amount equal to the penal sum of the bond offered must be duly pledged and deposited with the Director as collateral security * * *." (*Idem*., p. 75.)

The condition of these two bond forms (1408 and 1409), found in Regulations 60, pages 94-97, is:

| *Form* 1408 | *Form* 1409 |
|---|---|
| Now, therefore, the condition of this obligation is such that if there be no material false statement in the application for such | Now, therefore, the condition of this obligation is such that if there be no material false statement in the application for per- |

permit, and the said principal shall not violate the terms of such permit issued to him by the Commissioner of Internal Revenue, or any person authorized by him to issue permits on such application or shall not violate any of the provisions of the National Prohibition Act and regulations promulgated thereunder as now or hereafter provided, and all other laws of the United States now or hereafter enacted respecting distilled spirits, fermented liquors, wines, or other intoxicating liquors, and will pay all taxes, assessments, fines and penalties incurred or imposed upon him by law, then this obligation to be void, otherwise to remain in full force and effect.

mit, and the said principal shall not violate the terms of such permit issued to him by the Commissioner of Internal Revenue, or any person authorized by him to issue permits, on such application or shall not violate any of the provisions of the National Prohibition Act and regulations promulgated thereunder as now or hereafter provided, and all other laws of the United States now or hereafter enacted respecting distilled spirits fermented liquors, wines, or other intoxicating liquors, and will pay all taxes, interest assessments, fines and penalties incurred or imposed upon him by law, then this obligation to be void, otherwise to remain in full force and effect. The said principal expressly agrees that the said bonds so deposited may be sold at public or private sale, with or without notice of said sale and without notice of any character to the principal, and the proceeds applied to the payment of any internal revenue taxes, interest, fines, and penalties which may be due, and in satisfaction of any liabilities incurred hereunder and the expenses of such sale, if any; and the residue, if any, paid to the said principal.*

*Forms 1408 and 1409 do not appear in Regulations 60, as reported in the bound reports of Treasury Decisions, Internal Revenue. They appeared, however, as an appendix to Regulations 60, published in pamphlet form February 1, 1920, and in due course the official blanks of these forms were issued.

It must be recalled at this point that applicant in this case filed, and the Commissioner accepted, bond form 738 in lieu of form 1408 as prescribed by the regulations. Unquestionably this occurred for the sake of expediency, as both the application and the bond are dated within a month after the approval of Regulations 60. The bond is dated six days after their publication. Perhaps, too, the Court can take judicial knowledge of the fact that bond forms 1408 and 1409 were not physically available at Philadelphia until some date subsequent to the execution of the present bond.

Before the issuance of Regulations 60, the Commissioner of Internal Revenue had issued certain regulations under the National Prohibition Act, and for the enforcement of the Act of August 10, 1917 (40 Stat. 276), known as "Food Control Act;" and the Act of November 21, 1918 (40 Stat. 1045), known as the "War Prohibition Act;" and the Act of February 24, 1919, (40 Stat. 1057), known as the "Revenue Act of 1918" (Treasury Decision 2940, 21 Treasury Decisions, Internal Revenue, 875).

These regulations, so far as they refer to the giving of bonds to secure permits in connection with liquors for non-beverage purposes are practically the same in language as those sections of Regulations 60 referring to the same subject. These regulations provided for bonds on form 738 and 738 (A). After the approval of Regulations 60, applications for permit were to be accompanied by bond forms 1408 or 1409. These forms were substituted for the previous forms 738 and 738 (A). *Regulations 60, however, provided that in the instance of the then existing permit holders, if the*

*bond already given on form 738 or 738 (A) was in a sufficient penal sum, no new bond was required.* Section 20 (*c*), page 12, Regulations 60, in effect placed the older bond form in the same status as the new form. Both obligations were treated as identical. This was plainly warranted, reasonable, and consistent as a matter of regulation and is obvious when we glance at the condition of bond forms 738 and 738 (A), to wit:

*Form* 738.

Now, therefore, the condition of this obligation is such that if the said principal shall fully and faithfully comply with all the requirements of the laws of the United States now or hereafter enacted and regulations issued pursuant thereto respecting the sale or use of distilled spirits and wines for other than beverage purposes, then this obligation to be void; otherwise to remain in full force and virtue.

*Form* 738A.

Now, therefore, the condition of this obligation is such that if the said principal shall fully and faithfully comply with all the requirements of the laws of the United States now or hereafter enacted and regulations issued pursuant thereto respecting the sale or use of distilled spirits and wines for other than beverage purposes, then this obligation to be void; otherwise to remain in full force and virtue, and the said principal expressly agrees that the said bonds so deposited may be sold at public or private sale, with or without notice of said sale and without notice of any character to the principal, and the proceeds applied to the payment of any internal revenue taxes, interest and penalties which may be due, and in satisfaction of any liabilities incurred hereunder and the expenses of such sale, if any; and the residue, if any, paid to the said principal.

Comparing for the moment the phraseology of bond form 738 and 1408, we find the sole, substantial difference to be that form 1408 recites specifically that, in addition to observance of the law and regulations thereunder, the obligee "will pay all taxes, assessments, fines and penalties incurred." There is no distinction in obligation between Form 738 accepted in lieu of Form 1408 under Regulations 60 and the acceptance of Form 1408 itself. Form 738 was conditioned upon observance of the Regulations present and future. The Regulations 60, approved before the bond in this case was executed, provided that the bond should cover, *inter alia*, taxes and penalties. (See Sec. 20, Regulations 60, *Supra.*)

The valid regulations of the Treasury Department promulgated under the National Prohibition Act have the force and effect of law.

*Ex parte Reed*, 10 Otto, 13.

> "Laws in force at the time and place of the making of a contract, and which affect its validity, performance, and enforcement, enter into and form a part, of it, as if they should expressly refer to or incorporate it in its terms."
>
> *N. P. Ry. Co. vs. Wall.*, 241 U. S., 87, citing *Von Hoffman vs. Quinsey*, 4 Wall., 535-550.
>
> *Walker vs. Whitehead*, 15 Wall., 317.
>
> *Edwards vs. Kearzly*, 96 U. S., 595, 601.
>
> See also *Southern Surety Co. vs. Oklahoma*, 241 U. S., 582.

This principle of law applies to bonds, as well as other contracts.

*State vs. Nutter*, 44 W. Va., 385; 30 S. E., 67.
*Crawford vs. Ozark Insurance Co.*, 97 Ark., 549, 551; 134 S. W., 951.
*U. S. Fidelity and Guaranty Co. vs. Fultz*, 76 Ark., 410; 89 S. W., 93.
*People vs. Met. Surety Co.*, 211 N. Y., 107; 105 N. E., 99.

Applying these principles and giving the regulations their value in connection with the bonds, we find in form 1408 the detailed phraseology of the regulations, whereas in form 738 they are included by specific reference. As a result the contract is identical irrespective of the form used and the reasoning applicable to one is equally applicable to the other. The condition of the bond, therefore, is that the obligee will observe the National Prohibition Law, the regulations thereunder *and* will pay all fines, penalties, taxes, assessments, etc.

PROPER CONSTRUCTION OF THE BOND SHOWS IT TO BE AN INDEMNITY BOND AND NOT A FORFEITURE BOND.

(*A*) *By the language of bond itself.*

The opinion of the late Judge McKeehan in the instant case is the best example of the solution being reached by this type of reasoning. The pertinent phraseology of that opinion should be quoted at length here.

*O'Kane vs. Lederer,* 4 Federal Reporter, 2d Series, 418:

"The construction and effect that should be given to bonds required by statute and conditioned upon a compliance with the laws of a State or of the United States have been frequently before the courts and have usually presented questions of some difficulty. Clark *vs.* Barnard, 108 U. S., 436; U. S. *vs.* Alcorn, 145 Fed. 995; U. S. *vs.* Oteri, 67 Fed. 146; U. S. *vs.* Fidelity & Guaranty Co., 151 Fed. 534; U. S. *vs.* Montell, 26 Fed. Cas. No. 15,798; U. S. *vs.* Dieckerhoff, 202 U. S. 302; State *vs.* Larson, 83 Minn. 124; State *vs.* Eastabrook, 29 Kan. 739; U. S. *vs.* Cutajar, 59 Fed. 1000; also 32 opinions of Attorney General, 365. Generally speaking, where a statute requires the execution of a bond to a State or to the United States for a fixed penalty, conditioned upon a compliance with certain laws of a State or of the United States, the penalty named in the bond is the measure of damages for its breach or rather is a punishment inflicted by the sovereign for the violation of a pledge to observe its law, unless the statute or the bond read in the light of the statute indicates a less or a different measure. The question is always one of construction, having regard to the entire statute, the governmental regulations, framed to carry out the statute and the language of the bond.

"If the regulations and the language of the bond had followed the provisions of the Statute, I am inclined to think that the Government could recover the penal sum named in the bond and that the counter-claim would therefore be prop-

erly pleaded, although there is some force in the argument that since the National Prohibition Act is a criminal Statute providing fines or imprisonment or both for violations of its terms, the provision as to bonds contained in Section 6 was not intended as an additional punishment but simply as a protection to the Government for moneys due from the permittee. Be that as it may, and without considering what forms and amounts of bonds might be required by the commissioner in the exercise of the power delegated to him, it is evident that the particular bond now before the Court, read in connection with the regulation under which it was executed, does not name $2,000 solely as a penalty or punishment for a non-compliance with the terms of the permit and Title II of the act. *The amount named is expressly stated to cover also any taxes and penalties imposed under the Internal Revenue laws and to insure compliance also with the laws thereafter enacted and regulations issued pursuant thereto respecting the sale and use of wines and spirits for other than beverage purposes.* It follows that the $2,000 named in the bond cannot all have been intended as a fixed penalty or punishment for a violation of the permit and Title II of the Prohibition Act. I cannot but conclude, therefore, that the amount named in the bond represents a limit and not a measure of liability. Punitive bonds of this character, together with the statutory provisions and regulations under which they are required to be executed, should be construed, like tax laws, not according to what seems to be the probable broad, general intention of the Government, but strictly in ac-

> cordance with their provisions, and where reasonable doubts exist, they should be resolved in favor of the obligor upon whom the punishment is sought to be imposed." (Italics ours.)

Judge McKeehan found that the bond was conditioned not only on compliance with the National Prohibition Act and regulations thereunder, but also on the payment of internal-revenue taxes and penalties. Obviously, if any violation of the National Prohibition Act or any internal revenue law forfeited the entire penal sum of the bond, the taxes and penalties provided for could not be collected out of the bond. In order to give full effect to all provisions of the bond, only such amount could be collected thereunder as the Government could prove as damages for each and every violation established, such damages, of course, to include fines, penalties, taxes and assessments. If the bond is anything more than a measure of maximum recovery against obligors, provision for the payment of taxes and penalties is meaningless.

In support of this reasoning a strong analogy is found in Section 3260, R. S., of the Internal Revenue Laws dealing with distilleries. A person desiring to commence or continue the business of distilling was required to

> "* * * execute a bond in the sum prescribed by the Commissioner of Internal Revenue, conditioned that he shall faithfully comply with all the provisions of law relating to the duties and purposes of distilleries, and shall pay

> all penalties incurred or fines imposed upon him for violation of any of the said provisions. * * *"

In the case of *U. S. vs. Chouteau*, 12 Otto, 603, in construing Section 3260, it was alleged that the distiller (page 605):

> "* * * omitted to make, in a book he was required by law to keep, a true and exact entry of the kind and quantity of materials used by him in the production of distilled spirits, etc. * * *"

Mr. Justice Field, in the opinion (page 603), said:

> "Here a specific omission of duty on the part of the distiller is alleged, for which it is sought to charge both him and his sureties on their bond. Their liability is only to the extent of the damages sustained. As none resulted to the United States, from the omission stated, none can be recovered either against him or his sureties. The law does not affix any specific penalty for the omission."

It will be noted that Section 3260, R. S., required a bond conditioned on faithful compliance with the law and on the payment of all penalties incurred. In the instant case, Regulations 60 required a bond and the bond was written on the condition that the law be fully and faithfully complied with and that taxes, penalties, etc., be paid. It is thus apparent that if the bond in the Chouteau case, *supra*, was liable only for damages sustained by the Government, the bond in this case is liable only for such damages.

*(B) By comparison with companion bond.*

We believe we have demonstrated in the preceding discussion that bond form 738 by its own terms and in the light of the law and regulations under which it was exacted in this case is an indemnity and not a forfeiture bond. The same conclusion is, however, irresistibly reached by a contrast of the companion bond Form 738 (A) and by a comparison of bond form 1408 with its companion bond form 1409.

We invite the Court's attention again to the parallel columnar print of the bond forms at pages 5 and 8, *supra*, of this brief.

Even if form 738 may not clearly indicate its character or clearly set forth the purpose for which the bond is to be given, there can be no doubt as to the purpose of a bond executed on Form 738 (A).

The language of the two forms is identical down to and including the word "virtue" in bonds Forms 738 and 738 (A). The language following that word in Form 738 (A) clearly indicates the nature and character of the bond and the purpose for which it was given by providing that after a sale of the bonds the proceeds shall be applied to the payment of any internal revenue taxes, interest, and penalties which may be due, and in satisfaction of any liabilities incurred thereunder, together with the expenses of sale, if any. Then, with the purpose of the bond clearly stated, its character as an indemnity bond is established by the last clause providing for the *return of the residue* after payment of taxes, etc., to the principal. If the bond were a forfeiture bond there would be no residue

to return to the principal. If Form 738 (A) was intended to secure the payment of taxes, interest and penalties, Form 738 was undoubtedly intended to serve the same purpose. If Form 738 (A) is an indemnity bond and not a forfeiture bond, assuredly Form 738 is a bond of the same character, because there is nothing in the law or regulations to indicate that it was the intention of Congress or of the Treasury Department that a bond given by a permit holder who chose to furnish personal surety, or a surety company, on his bond, should be considered as a forfeiture bond, while a bond given by a permit holder who chose to deposit Government bonds as security should be considered an indemnity bond merely.

The Commissioner, in providing in the regulations for the furnishing of a bond with United States bonds as security, was merely following the Act of Congress of February 24, 1919, Section 1320 (40 Stat., 1148), which provides in part as follows:

> "That wherever by the laws of the United States or regulations made pursuant thereto, any person is required to furnish any recognizance, stipulation, bond, guaranty, or undertaking, hereinafter called 'penal bond,' with surety or sureties, such person may, in lieu of such surety or sureties, deposit as security with the official having authority to approve such penal bond, United States Liberty Bonds or other bonds of the United States in a sum equal at their par value to the amount of such penal bond required to be furnished, together with an agreement authorizing such official to collect or sell such bonds so deposited in case of any default

in the performance of any of the conditions or stipulations of such penal bond. The acceptance of such United States bonds in lieu of surety or sureties required by law shall have the same force and effect as individual or corporate sureties, or certified checks, bank drafts, post office money orders, or cash, for the penalty or amount of such penal bond. The bonds deposited hereunder, and such other United States bonds as may be substituted therefor from time to time as such security, may be deposited with the treasurer, or an assistant treasurer of the United States, a government depositary, Federal reserve bank, or member bank, which shall issue receipt therefor, describing such bonds so deposited. As soon as the security for the performance of such penal bond is no longer necessary, such bonds so deposited shall be returned to the depositor."

It is plain, therefore, that the companion forms of bond are intended to be of exactly the same character.

Then let us take Form 1408 and Form 1409, provided for by "Regulations 60," promulgated by the Commissioner of Internal Revenue and the Secretary of the Treasury on January 16, 1920, prior to the giving of the bond in question here. Sections 20 to 24, inclusive, of said "Regulations 60" provide for the giving of bonds by persons desiring to obtain permits and that said bonds shall be made on Form 1408 or 1409: on Form 1408 when corporate surety or two personal sureties are furnished, and on Form 1409 when United States Government bonds are deposited.

The language used in Form 1409 just as clearly in-

dicates the purpose of the bond and just as clearly characterizes it as an indemnity bond as does the language in Form 738 (A).

The first case brought by the Government in which it alleged that the bond Form 738 was a forfeiture bond and not an indemnity bond was the case of *United States vs. Wandmaker*. The District Court sustained the demurrer, holding that the bond Form 738 was not a forfeiture bond and on appeal the Circuit Court of Appeals affirmed that finding. See *United States vs. Wandmaker*, 292 Fed., 24. The Circuit Court of Appeals in that case held that the two forms of bond, *i. e.*, the bond secured by corporate surety and the bond secured by Government bonds as collateral, either of which the permittee had the right to give, were identical in obligation. The court further said:

> "If the form requiring deposit of Liberty or other United States bonds had been given by Wandmaker, there can be no doubt that the ruling on the demurrer was right. The $2,000 named in the bond would not have been an agreed sum to be forfeited on breach, but a penal sum to secure damages suffered in taxes, interest, penalties, and other liabilities of the permittee unpaid. How, then, can the obligation in the form that was used be said to be different? We fail to find any reason for so holding. The two forms of bond were for the same purpose."

The Government made no attempt to review the findings of the Circuit Court of Appeals in the Wandmaker case.

It is clear that the option given to permittees to file bonds secured either by corporate surety or by collateral indicates by the very terms of the collateral bond that the bonds were not intended to be of forfeiture character.

(C) *The multiplicity of conditions of bond establish it to be an indemnity bond.*

Other equally well-founded arguments tend to the same conclusion that the intention of the Government was not by the form of bond Nos. 738 and 1408 to exact a forfeiture in these cases.

By the terms of Section 6 of Title II of the Prohibition Act the Commissioner was empowered "to require a bond in such form and amount as he may prescribe to insure compliance with the terms of the permit and the provisions of this title."

The Commissioner was not content with establishing in his Forms 738 and 1408, as a condition of the bond, the mere insuring of compliance with the terms of the permit and the provisions of the title. The condition of the obligation contains many separate ideas, some of which are curiously intermingled and dependent upon others, but the multiplicity of which is in any event evident. The condition of the obligation is that the obligees shall—

(1) Comply with the terms of the National Prohibition Act;

(2) With the terms of regulations thereunder;

(3) With future modifications or amendments of that Act;

(4) With future modifications or amendments of the regulations thereunder;

(5) With the terms of the permit;

(6) With all other laws of the United States respecting liquors, which includes the internal revenue laws for the collection of taxes.

This is truly a multiple undertaking on the part of both principal and surety. It is unnecessary to give illustrations of the multitude of requirements, some grave and some merely advisory or directory, some with express pains and penalties set forth in the laws, and some so trifling in comparative importance as to be present only as suggestions of what should or should not be done by permittees in conduct of permitted business; any single act contrary in any way or degree of laws and regulations would, however, were the bond a forfeiture bond, work forfeiture of a sum far in excess of statutory fines enacted in case of fundamental violation of the Prohibition Act itself. For the violation of any one of these multiple undertakings, diverse and disproportionate in their consequences though they prove, the obligors under the bond, according to the theory of the Government, are liable for the full sum of the bond.

In *Watts vs. Camors*, 115 U. S., 353, the court construed a charter-party, by the concluding clause of which the parties bound themselves "to the true and

faithful performance of all and every the foregoing agreements—in the penal sum of the estimated amount of freight." The charter-party contained full details as to the time and method of loading the vessels and the amount of the cargo. The court said:

> "The principal object of this clause appears to be to pledge the ship and freight as security for the performance of the agreement of the owner on one hand and the merchandise to be laden on board as security for the performance of the agreements of the charterer, on the other. It is in the form of a penalty; it covers alike and entirely refusal to perform the contract, and a failure to perform it in every particular, however, slight; and for any breach, whether total or partial, and just compensation can be estimated in damages.
>
> "At the common law, indeed before the statute of 8 and 9 William the 3rd, Chapter 11, Sec. 8, judgment might have been rendered for the full amount of the penalty. But in a case like this a Court of Equity would stay proceedings at law, upon payment of the damages actually suffered. Clark *vs.* Bernard, 108 U. S., 436, 453; Sloman *vs.* Walter, 1 Bro. Ch., 418; *In re* Newman, 4 Chanc. Div., 724. And at the present day even a court of law would regard such a clause in such a contract as a penalty only and not as liquidated damages. Taylor *vs.* Sandiford, 7 Wheat., 13; Van Buren *vs.* Digges, 11 How., 461, 477; Higginson *vs.* Weld, 14 Gray, 165; Harrison *vs.* Bright, 13 East, 343."

In *Bignall vs. Gould*, 119 U. S., 495, a bond was given to secure the obligee's discharge from a large number

of claims against him, amounting to approximately $39,000 and varying from more than $8,000 to less than ten dollars each. The stipulated sum given in the bond was $10,000, and it was claimed that this constituted liquidated damages. The court, however, said:

> "A failure of either of those persons (that is, any creditor) to release any one of those claims would be a breach of the bond; and for any such breach a just compensation might be estimated in damages. The sum of $10,000 must therefore be regarded as simply a penalty to secure the payment of such damages as the obligee may suffer from any breach of the bond. Watts *vs.* Camors, 115 U. S., 353; Boys *vs.* Anceli, 5 Bing. N. C., 390; Thompson *vs.* Hudson, L. R. 4, H. L. 1, 30; Fisk *vs.* Gray, 11 Allen, 132."

In the case of *Sun Printing Co. vs. Moore*, 183 U. S., 642, in which the court concluded that the stipulated sum represented liquidated damages as distinguished from indemnity, it will be observed that there was but one covenant in the charter-party, namely, the obligation to return the yacht at the expiration of the term of hiring, so that the court could not apply the rule which exists in cases where there is a breach of one or more distinct covenants in an agreement.

In *Robinson vs. United States*, 261 U. S., 486, and in *United States vs. Bethlehem Steel Company*, 205 U. S., 105, there was essentially one act and one covenant provided for in each instance.

In *O'Brien vs. Illinois Surety Company*, 203 Fed., 436, the Circuit Court of Appeals expressly recognizes

the importance of this distinction in the following language:

> "The court below properly held against plaintiff's theory that he was entitled to recover the sum named in the bond as liquidated damages."

The court then refers to

> "the well-established principle that the penalty cannot be considered as the sum agreed upon for liquidated damages, when it appears that it was to secure the performance of each of several different conditions of varying degrees of importance and involving varying amounts of injury to the obligee. (Bignall *vs.* Gould, 119 U. S., 495; Lansing *vs.* Dodd, 45 N. J. L., 526.)"

The identical rule is recognized by the Circuit Court of Appeals for the Eighth Circuit in *C., B. & Q. Railroad Co. vs. Dockery*, 195 Fed., 221. To the same effect was *Northwestern Terra Cotta Co. vs. Caldwell*, 234 Fed., 491, especially at 496.

See also *Willson vs. Mayor and City Council*, 83 Md., 203, 212.

In *Hough vs. Kugler*, 36 Md., 186, at 195, Chief Judge Bartol approves the language of Baron Parke in *Horner vs. Flintoff*, 9 M. & W., 678:

> "The rule laid down in Kemble *vs.* Farren was that when an agreement contained several stipulations of various degrees of importance and value the sum agreed to be paid by way of damages for the breach of any of them shall be construed as a penalty and not as liquidated damages, even though the parties have in express

> terms stated the contrary. * * * When parties say that the same ascertained sum shall be paid for the breach of any article of the agreement, however minute and unimportant, they must be considered as not meaning exactly what they say, and a contrary intention may be collected from the other parts of the agreement."

So well recognized is this rule that Sedgwick in his book on the Measure of Damages adopts the following statement as the heading for Section 413 of his book:

> "A sum fixed as security for the performance of a contract containing a number of stipulations of widely different importance, breaches of some of which are capable of accurate valuation for any of which the stipulated sum is an excessive compensation, is a penalty."

Citing, among other cases, *Watts vs. Camors*, 115 U. S., 353; *East Moline vs. Weir Plow*, 95 Fed., 250; *Charleston vs. Bond*, 26 Fed., 18; *Hough vs. Kugler*, 36 Md., 186.

See similarly *Johnson vs. Cook*, 24 Wash., 474; *City of El Reno vs. Callinane*, 4 Okla., 457; *Wilhelm vs. Eaves*, 21 Ore., 194; *Raymond vs. Eddelbrook*, 14 N. D., 231; *State of Minnesota vs. Larson*, 83 Minn., 124.

In the last-named case the complaint alleged that a druggist had made application for a license, and that a bond in the sum of two thousand dollars ($2,000) had been executed; that the license had been duly issued; that there was a violation of the law in that the defendant sold certain malt liquors to a minor; that he was arrested, convicted and was ordered to pay a fine

of $25.00 and costs; that he paid the fine and costs and was discharged. The court held the amount fixed by the statute at two thousand dollars ($2,000) was as indemnity, and that it was not in the nature of liquidated damages to be recovered as an entire sum in case any of the conditions of the bond were violated.

*Bonds given to the United States are not inherently of forfeiture character.*

It has been argued, that while the sum fixed in a bond containing a number of different obligations is in general to be regarded as indemnity as distinguished from a forfeiture, nevertheless this rule has not applied to two classes of cases—first, where the bond is given under a statute, and, secondly, where the bond is given to the United States or to a State. An expression of this theory is to be found in the Engelberg decision in the District Court for the Western District of Pennsylvania, 2 Fed. (2d), 720. In this opinion Judge Thomson, in overruling a demurrer to a suit on an internal-revenue bond, No. 1408, relied chiefly upon the cases of *Clark vs. Bernard*, 108 U. S., 436; *United States vs. Montell*, 26 Federal Cases, 15798, and *Illinois Surety Co. vs. United States*, 229 Fed., 527.

It is submitted that an examination of these cases will show that there were in each instance outstanding reasons leading to the construction of the fixed sum as liquidated damages. In *Clark vs. Bernard* the bond had been given under the express words of a statute requiring the railroad company to give bond with

surety "in the sum of one hundred thousand dollars ($100,000) that they will complete their said road before the first day of January, 1872." It is submitted that when a statute so clearly provides the conditions under which a company will be permitted to construct a railroad, then the sum named in the bond is obviously inserted only for the purpose of establishing a fine or criminal penalty for failure to comply with the condition named in the statute itself.

In such a case the intention is manifest that the sum of one hundred thousand dollars ($100,000) shall be forfeited upon failure of the corporation to complete the railroad within the time named. No such situation is presented in the case at bar. As is pointed out in the Wandmaker opinion, *supra*, the intention that the sum named shall be regarded as a penalty appears not only from the multiple number of undertakings included in the bond, but also from the fact that the Internal Revenue Commissioner himself has prescribed a choice of either a collateral or a surety bond, in the former of which it is expressly stated bonds are given for the purpose of insuring to the Government payment of taxes, fines and assessments. We, therefore, submit on this branch of the case that the correct rule is that the sum fixed by the bond does not because of the fact that the bond is required by statute become a forfeiture. In order for it to become a forfeiture the statute which demands the giving of the bond must clearly indicate that the amount named is to be regarded as a forfeiture rather than an indemnity.

In the Engelberg decision reliance is also placed upon the Montell case. In this case the Act of December 21, 1792, provided that previous to every registry of a ship the master should become bound to the United States in a sum fixed by the tonnage of the vessel for the return of whose registry the master was bound; that such registry shall be solely used for the vessel for which it is granted, and if the vessel is lost or prevented from returning to port the registry shall be preserved. The main object of the statute was to secure the return of the registry and to preserve it from improper use. The 29th section of the act declared that all the penalties and forfeitures incurred by infringements against that act should be divided in equal proportions between the collector, naval officer, and surveyor. The court held upon failure of Montell to return the registry that the sum for which the parties became bound was "manifestly a penalty or forfeiture inflicted by the sovereign power for a breach of its laws. It is not a liquidated amount of damages due under a contract, but a fixed and certain punishment for an offense." The reason that the managing director and master of the vessel were required to be parties to the bond was that they were the persons who had the custody and control of the certificate of registry, "and are, therefore, the proper objects of punishment if it is not delivered up according to law; they are required to be parties in order that the penalty punishment for the offense may be imposed upon them." The court specifically held that under the statute in question a form of punishment had

been provided by the statute, and that the amount paid was not even to be treated as liquidated damages.

So far as the Illinois Surety Company case is concerned, it has been distinguished by Judge Hazel in his opinion in *United States vs. U. S. Fidelity & Guaranty Company*, 1 Fed. (2d), 335, and we are content to quote his discussion of it:

> "Stress is placed by the Government on Illinois Surety Company *vs.* U. S., 229 Fed., 527, wherein Judge Rogers, writing for the Circuit Court of Appeals for this Circuit, sustained the right of the Government to recover the full penalty of a bond executed to procure admission of alien children into the country regardless of whether the Government had suffered damage or not. That case, however, is not like this. The bond was different and there was no penalty for infraction of the prohibition law nor was it based upon a form prescribed by a duly authorized official in compliance with a regulation conferring the right upon him to impose obligations. The recovery was not limited to the compensatory amount nor were the obligors bound to 'pay all taxes, assessments, fines and penalties incurred or imposed upon them by law.'"

The Government relies on the decision in *Lyman vs. Perlmutter*, 166 N. Y., 410, involving a liquor dealer's bond; but there the bond was taken under provision of the State statute and was one of the uniform punishment elements of the law. The decision is clearly distinguishable from this case. The Kansas cases involving the use of penal bonds are in point here; in

those cases the bonds were held to be civil in character and not in the nature of criminal recognizances. See *State vs. Estabrook*, 29 Kans., 739; *State vs. Pierce*, 26 Kans., 777.

We submit that the mere fact that the bond is given under a statute or to a State does not determine whether the sum named is intended as a punishment or otherwise.

(D) *History of bond form 738 and administrative construction show it to be an indemnity bond.*

The genesis of the form of bond here in issue is stated by the Government to be found in Treasury Decision No. 2559, October 26, 1917 (19 Treasury Decisions Internal Revenue, 290), under the Food Control Act of August 10, 1917, and the Revenue Act of October 3, 1917. The Food Control Act, by Section 15, placed limitations upon the production of distilled spirits for beverage purposes and the revenue measure placed a higher rate of tax on distilled spirits withdrawn for beverage use than upon distilled spirits withdrawn for non-beverage use. The form of bond unnumbered, contained the following condition:

> "Now, therefore, the condition of this bond is such that if the said principal shall fully and faithfully comply with all of the requirements of the Act of Congress approved August 10, 1917, known as the Food-Control Act, and all regulations pursuant thereto, and with all the requirements of the internal revenue laws of the United States, and all regulations issued pursu-

ant thereto, then this obligation to be void; otherwise to remain in full force and effect" (*Idem*, p. 297).

If that is the genesis, as alleged by the Government, then special attention must be called to the fact that it contemplated not only compliance with the Food-Control Act, but in addition provided for observance of the internal-revenue laws, which are primarily for the collection of taxes, interest and penalties thereunder. That this was the chief purpose of the bond is shown by the regulation as follows:

> "The penal sum of the bond will be three times the difference between the tax on beverage and non-beverage spirits, on the quantity of spirits which, according to the application for the permit in the case, will at any time remain outstanding *against the bond*" (*Idem*, 296). (Italics in this and subsequent excerpts from the regulations are ours.)

By Treasury Decision 2576, November 10, 1917 (19 Treasury Decisions, Internal Revenue, 333, 334), the foregoing Treasury decision was modified to permit the collector of internal revenue to accept alternatively a bond with personal sureties or one collateraled with Government bonds, in an amount equal to the penal sum of the bond. That decision also provided that in case the same person, firm or corporation operated a number of drug stores in the same city, the withdrawal or purchase for sale or use of alcohol for non-beverage purposes at all of these stores could be covered by a single bond and permit, the bond in such case, however,

to be in a sufficient amount to cover the operations at all of the different stores. It is to be noted that the theory of forfeiture for a single violation cannot in reason be sustained in this multiple cover of several operations by a single bond gauged on gross operations.

Treasury Decision 2788, February 6, 1919 (21 Treasury Decisions, Internal Revenue, 7), extended the existing regulations to cover the War Time Prohibition Act of November 21, 1918.

That decision stated (par. 1, p. 9) as follows:

> "The following regulations are hereby promulgated under the foregoing acts, under the order of the President of the United States, pertaining to the sale and use of distilled spirits and wine manufactured for other than beverage purposes, and under the Act of October 3, 1917, and the Revenue Act of 1918, making a distinction in the rates of taxation on distilled spirits produced for other than beverage purposes and those produced for beverage purposes."

The Court will note that the tax differential between beverage and non-beverage spirits was continuously in the mind of the Executive Department in making regulations; and was particularly employed in fixing the penal sum of bonds. This is shown in this particular treasury decision by Article 9, paragraph (*c*) (*idem*, p. 17), as follows:

> "The basis of the penal sum of the bond will be once the difference between the tax on beverage and non-beverage spirits, *on the quantity of spirits which, according to the application for*

> *the permit in each case will at any time remain outstanding against the bond*, plus the total tax imposed on the wines which will at any time remain outstanding."

In paragraph (*d*) it was provided

> "New bonds will at once be required in all cases *unless the quantity of spirits debited against the bond* is such that the existing penal rate is sufficient."

In Article 10 (*idem*, p. 19) it was provided with respect to additional withdrawal of liquors as follows:

> "The applicant will also see that the tax on the spirits and wines outstanding *as a debit against his bond*, as well as the additional quantity applied for, *is not such in the aggregate that the tax on the spirits at the differential rate, plus the tax on the wines, will exceed the penal sum of his bond.*"

These extracts from these regulations make it patent that the bond was intended primarily as a tax bond, that possible tax obligation believed to exist by the Executive Department was to be commensurate with the bond, that the bond was to be *debited* therewith; that the bond was to be enlarged if necessary to meet the obligation; and permittees were to see that their *tax debit* would not exceed the penal sum of the bond. A *tax debit* cannot exist unless an accounting is contemplated, *i. e.*, the ascertainment of an unliquidated amount, and in no sense can refer to a forfeiture.

These observations become all the more cogent in as-

certaining the contemporary departmental understanding of the bond in issue in this case when it is discovered that bond Form 738 appears as such for the first time in the Treasury decision containing the foregoing provisions (*Idem*, page 19).

Treasury Decision 2940, October 29, 1919 (21 Treasury Decisions, Internal Revenue, 875), provided regulations under all the preceding acts heretofore mentioned and the revenue act of 1918, and extended the regulations to cover the National Prohibition Act. Bond Form 738 was again set forth (*idem*, 888) as previously promulgated. These regulations also provided Bond Form 738A, to be employed in case United States bonds were deposited as collateral.

These regulations, the first promulgated under the National Prohibition Act and bearing directly on this case, renewed the provision respecting sufficiency of penal sum to meet debits based on quantity of liquor.

> "Whenever the quantity of spirits and wines *debited against the bond* is such that the existing penal sum is not sufficient, a new bond must be furnished in sufficient sum *to cover all liability*" (*idem*, 885).

Article (*f*) (*idem*) was as follows:

> "The basis of the penal sum of the bond (form 738 or 738A) covering the use or sale of nonbeverage spirits is $4.20 per proof gallon, on the quantity of spirits which will be received during any semi-annual period, plus the amount of nonbeverage spirits on hand at the end of the preceding period.

"The penal sum of bonds covering wines will be computed at the rate of $100 for each 200 gallons, or any fractional part thereof, of wines which will be received during any semi-annual period, plus the amount on hand at the end of the preceding period.

"The penal sum of a bond to cover both non-beverage spirits and wines shall be the aggregate sum of the amount required for each.

"*Provided, however*, that the minimum penal sum of any such bond shall be $1,000, and the maximum $100,000."

Treasury Decision 2985, comprising Regulations 60 under the National Prohibition Act of October 28, 1919, was approved January 16, 1920, the effective date of national prohibition (22 Treasury Decisions, Internal Revenue, 65-126). These regulations provided for bonds by persons desiring to obtain permits on bond forms 1408 or 1409, "to insure compliance with the provisions of this act and of these regulations, *as well as to cover any taxes and penalties which may be imposed under the internal-revenue laws.*" Form 1408 was the surety bond and 1409 was the collateral bond. As previously shown, these bonds are interchangeably referred to (*idem*, 74) and were used concurrently under the regulations with forms 738 and 738 (A). The basis of the penal sum was continued as it existed under bonds forms 738 and 738A, at $4.20 per proof gallon on distilled spirits and $100 for each 200 gallons or fractional part thereof on wine, malt liquor, cider, or other liquor manufactured or received during the quarterly period of the calender year.

In view of the employment of this form of bond originally in aid of the Food-Control Act, and in contemplation of the differential tax between beverage and nonbeverage spirits under the revenue act of 1917, the gauging of the penal sum of the bond upon the quantity of distilled spirits to be handled by the permittee principal, and the reference to the debits and charges outstanding against the bonds, repeatedly mentioned in the succeeding regulations governing the same, it is plain that the bond on Form 738 was not conceived by the Government, or by principals and sureties thereon, to be intended by the parties as a forfeiture bond.

The Government cites the opinion of the Attorney General of December 16, 1920 (32 Op. Atty. Gen., 365), in support of its theory of administrative construction of the bond.

This opinion, issued some ten months after the bond in this case was executed, tends to show that prior thereto the Treasury Department had not considered the bond to be a forfeiture bond. The inquiry of the Secretary of the Treasury referred to Bond Form 738, but stated that upon the passage of the National Prohibition Act it had been felt that a new bond was desirable and accordingly Form 1408 was adopted. It appeared that if Form 738 should be substituted for Form 1408, surety company premiums would be reduced (certainly an indication that both public and private parties dealing with Form 738 conceived the bond to be no more hazardous than Bond 1408); and the inquiry was made whether Form 738, if substituted for Form 1408, would be legally sufficient to in-

sure *collection of taxes and penalties* relating to distilled spirits and wines and the manufacture and sale thereof *assessable under Title II of the National Prohibition Act and the internal-revenue laws.*

This inquiry was doubtless made in view of the fact that Form 738 contained no specific provisions with reference to the payment of taxes, while Form 1408 contained language mentioning the collection of taxes, penalties, etc., specifically.

The Attorney General in his opinion stated that Bond Form 738 could hardly be said to be available for recovery of taxes and penalties, but reached the conclusion that the bond was a forfeiture bond.

It is apparent that the Attorney General did not take into consideration Bond Form 738A, the companion bond, providing for the payment of internal-revenue taxes, interest and penalties; that he had not reviewed the regulations as a whole. His opinion, given many months after the bond in this case had been executed, cannot be invoked to establish any contemporaneous or long-continued departmental construction holding the bond a forfeiture bond.

The very nature of the inquiry by the Secretary of the Treasury discloses a contrary prior construction. He then for the first time questioned the sufficiency of Bond Form 738 to insure the collection of the taxes and penalties for which that bond had previously been accepted by the Treasury Department, and neither surmised nor suggested in his inquiry that the bond was administratively deemed to be for forfeiture.

It may fairly be stated that only after the Attorney

General's opinion initiated the notion of forfeiture was there any suggestion by the Executive Department that the Bond Form 738 had assumed the character of a forfeiture bond.

Nor is this conclusion impaired by the provision of the Treasury Decision 2788, Article 18 (21 Treasury Decisions, Internal Revenue, 28):

> "Any person who violates these regulations is subject to the penalties provided by (1) the Act of August 10, 1917; (2) the Act of November 21, 1918; and (3) the Revenue Act of 1918, *as well as to liability on his bond.*"

or the similar provision in Treasury Decision 2559, referred to by Government counsel.

On the contrary the reference to liability on the bond can be construed only as relating to various and several liabilities growing out of the several laws recourse for which might be had against the bond.

Had this reference, instead of saying "as well as to *liability* on his bond," said "as well as to *forfeiture* of his bond," Government counsel might have contended for the departmental holding of the bond to be forfeitable that is now asserted. But, as shown, the whole course of dealing and administration by all parties was to the contrary until the Government changed its position late in 1920.

## POINT 2.

**If a Forfeiture Bond is Required or Authorized by the National Prohibition Act, Then Bond 738 is Unreasonable in Form and the Commissioner has Exceeded His Authority.**

On this point, for sake of discussion, let us concede, that the National Prohibition Act by statutory provision permitted the exaction of a forfeiture bond, and further that Bond Form 738 prescribed by the Commissioner pursuant thereto was, on its face, a forfeiture bond. In other words, admitting for argument, *in toto*, the Government's contention, the query then becomes pertinent, was this form of forfeiture bond a proper one within the power conferred upon the Commissioner?

Unquestionably it was in the Commissioner's province to make reasonable regulations to carry out administrative detail in enforcing the act. *U. S. vs. Grimaud*, 220 U. S., 506. But, on the other hand, he could not by regulation restrict or add to the law as enacted. If, therefore, he were permitted to exact a forfeiture bond, and such forfeiture bond was in the nature of an additional statutory penalty, nevertheless, the form of bond would have to be a just, reasonable and conscienable one. *U. S. vs. George*, 228 U. S., 14, 21. If it were not then the bond would be void on the ground that he had usurped authority not conferred and had attempted to change the law itself.

In this respect we take the position that the

orm of bond demanded, even though a forfeiture ond, was both unreasonable and unconscienable. This can be shown most convincingly by citing, for xample, possible and most probable instances which ave arisen and would arise under this form of bond. A has filed a bond for $1,000, whereas B is under bond n the sum of $100,000. The men are in the same busi- ess. Both commit identical offenses. On the theory f a forfeiture bond, in the latter case the punishment s one-hundred fold greater than in the former. On he other hand, if A's offense is most flagrant and B's iolation a mere technical one, nevertheless the minor elinquent is more severely punished.

The result reached, therefore, is that as a forfeiture ond it works disproportionate penalties for similar ffenses and a greater penalty for the lesser violation nd leads irresistibly to the conclusion that the Com- issioner worked an absurd and ridiculous exercise f the authority conferred. This is abhorred in the aw. *U. S. vs. 1,412 Barrels of Distilled Spirits*, Fed. ases, No. 15,960. The conclusion, therefore, is that his bond, in the form exacted, if it is a forfeiture bond, nust be without authority, because in form it is unrea- onable in creating disproportionate and unconscien- ble penalties.

The bond, in order to be deemed valid as a proper xercise of authority by the Commissioner under the aw, must be construed as an indemnity bond and not s a forfeiture bond.

## Decisions of the Lower Federal Courts.

A majority of the Federal Courts passing on the question here involved have held that the bond was an indemnity and not a forfeiture bond.

It is shown that two Circuit Judges and seven District Judges have held the bond not to be a forfeiture bond:

1. *U. S. vs. Wandmaker* (Aug., 1923) (Sanborn and Lewis, Circuit Judges, and McGee, District Judge, C. C. Appeals, 8th Circuit), 292 Fed., 24.

2. *Lederer, Collector, vs. O'Kane* (D. C. E. D. Pa., McKeehan, J.) (Oct., 1923), 4 Fed. (2d), 418.

3. *U. S. vs. National Surety Co. and Carssow Drug Company* (D. C. D. Idaho, Dietrich, J.) (Feb. 4, 1924).

4. *U. S. vs. U. S. Fidelity & Guaranty Co.* (D. C. W. D. N. Y., Hazel, J.) (March, 1924), 1 Fed (2d), 335.

5. *U. S. vs. American Surety Co.* (D. C. E. D. N. Y., Garvin, J.) (Oct. 7, 1924).

6. *U. S. vs. Zerby and National Surety Co.* (D. C. M. D. Pa., Witmer, J. (Dec. 26, 1924).

That the decision of District Judge Thompson in the case of *U. S. vs. Engelberg*, in the W. D. of Pa., 2 Fed. (2d), 720, and the decision of District Judge Soper (no opinion filed) in *U. S. Fidelity & Guaranty Co. vs. U. S.*, in the D. C. for D. Md., and now pending as No. 2369 in the C. C. Appeals, Fourth Circuit, holding that the bond is a forfeiture bond, are *contra*.

## Conclusion.

It is respectfully urged that:
Question No. 1 should be answered "no."
Question No. 2 should be answered "yes."

Respectfully submitted,

FREDERICK W. BREITINGER,
*Attorney for Mary A. McGarvey,*
*Executrix, etc.*

LEVI COOKE,
GEORGE R. BENEMAN,
*Of Counsel.*

# SUPREME COURT OF THE UNITED STATES.

No. 120.—October Term, 1925.

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|---|---|
| Ephriam Lederer, formerly Collector of Internal Revenue, *vs.* Mary A. McGarvey, Executrix of the Estate of Francis O'Kane. | On Certificate from the United States Circuit Court of Appeals for the Third Circuit. |

[May 24, 1926.]

Mr. Justice Sanford delivered the opinion of the Court.

The Circuit Court of Appeals has certified to us in this case the same questions that were submitted in *United States* v. *Zerbey*, No. 790, this day decided, in reference to permit bonds covering the sale and use of distilled spirits and wines for other than beverage purposes.

It appears from the certificate that on March 20, 1920, after Regulations 60 had been promulgated, prescribing a surety bond on Form 1408, a permit was issued to O'Kane on a surety bond in the penal sum of $2,000, executed on Form 738. While this permit was in force O'Kane violated the National Prohibition Act and the regulations by selling whiskey to a pharmacy having no permit to purchase it, and failing to keep a record of the sales as required by the regulations. He was assessed with a differential tax of $1,098.72. He paid this, under protest, to Lederer, the Collector of Internal Revenue, and thereafter brought suit against Lederer in a Federal District Court to recover the amount paid. Lederer, while conceding this claim, interposed a counterclaim for $2,000 on the surety bond, the full amount of which, he insisted, had become due to the United States by reason of the breach of condition. The District Court, holding that "the amount named in the bond represents a limit, and not a measure of liability", denied the counterclaim, and gave O'Kane judgment for the amount of the tax paid. 4 F. (2d) 418. And the case having been taken to the Circuit Court of Appeals on a writ of error, it has certified to

us, in effect, the questions whether a surety bond executed o Form 738—after Form 1408 had been prescribed—is a forfeitu bond entitling the United States to recover the full amount name on a breach of its condition, or an indemnity bond merely.

In the brief filed in this Court in behalf of Lederer, it is no said that the decision in *Sage* v. *United States*, 250 U. S. 33, "mak it plain that, in defending an action for the recovery of tax alleged to have been illegally collected, a collector of intern revenue is not acting for and in behalf of the United States, bu is seeking to prevent the entry of a personal judgment again himself"; and that it "would apparently follow that the collect is without right in such a case to set up as a counterclaim a alleged indebtedness of the plaintiff to the United States." And i is suggested that, "as the judgment of the District Court mus be affirmed by the Circuit Court of Appeals without regard to th points presented in the certified questions", an answer to thes questions, which would avail nothing, is not required. *Unite States* v. *Buzzo*, 18 Wall. 125, 129; *United States* v. *Britton*, 10 U. S. 199, 207.

In view of the concession now made by Lederer, this suggestio is not opposed by the counsel for O'Kane's executrix. Accor ingly, without answering the question certified, the

*Certificate is dismissed.*

A true copy.

Test:

*Clerk, Supreme Court, U. S.*

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# SUPREME COURT OF THE UNITED STATES.

No. 790.—October Term, 1925.

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| The United States of America, *vs.* John E. Zerbey and National Surety Company. | On Certificate from the United States Circuit Court of Appeals for the Third Circuit. |

[May 24, 1926.]

Mr. Justice Sanford delivered the opinion of the Court.

This case comes before us on a certificate from the Circuit Court of Appeals. Jud. Code, § 239.

It appears from the certificate that Zerbey on January 23, 1920, applied to the Commissioner of Internal Revenue, under the provisions of the National Prohibition Act[1], for a permit to sell distilled spirits and wines for other than beverage purposes, and filed with his application a bond in the sum of $100,000, with the National Surety Company as surety. This bond was on Form 738, previously prescribed by the regulations, and recited, in accordance therewith, that "the condition of this obligation is such that if the said principal shall fully and faithfully comply with all the requirements of the laws of the United States now or hereafter enacted and regulations issued pursuant thereto, respecting the sale or use of distilled spirits and wines for other than beverage purposes, then this obligation to be void; otherwise to remain in full force and virtue." On January 26, the Commissioner issued to Zerbey a permit "under the conditions that the provisions of the national prohibition act, and regulations issued thereunder will be strictly observed."

Thereafter the United States brought an action against Zerbey and the Surety Company in a Federal District Court, in which it was alleged that Zerbey had violated the condition of the bond in (a) failing and neglecting to keep records of his sales of distilled spirits, as required by the Prohibition Act and regulations, (b)

[1]41 Stat. 305, c. 85.

selling and disposing of distilled spirits for beverage purposes, (c) diverting distilled spirits to other than beverage purposes, and (d) having in his possession whiskey which had been withdrawn, for nonbeverage purposes only, from a bonded warehouse, of which he kept no record as required by the Prohibition Act and regulations; and that the full penal sum of the bond had been forfeited and was due by the defendants to the United States by reason of these breaches of the condition of the bond. It was not alleged that any damage or loss had been sustained by the United States as the result of these breaches. The defendants filed statutory demurrers, which were sustained by the District Court on the ground that the United States could not recover the full penal sum of the bond, but only such loss or damage as it had sustained in consequence of the breaches of the bond; and the suit was dismissed. And the case having been taken to the Circuit Court of Appeals by writ of error, it has certified that, for the proper decision of the case, it desires the instruction of this Court as to the following questions of law: "(1) Is a bond conditioned upon compliance with the law of the United States and regulations issued pursuant thereto, respecting the sale or use of distilled spirits and wines for other than beverage purposes, given the United States by one to whom a permit to sell intoxicating liquors for other than beverage purposes has been issued under the provisions of section 6 of Title II of the national prohibition act and regulations promulgated thereunder, forfeitable upon breach of the condition in the full amount of its penal sum? (2) Is recovery upon breach of the condition of such a bond given by one holding such a permit limited to actual damages sustained by the United States?"

These questions, shortly stated, are, in effect: Whether a permit bond on Form 738 is a forfeiture bond entitling the United States to recover the full amount named on a breach of its condition, or a bond of indemnity for the actual damages sustained by the United States from such breach.

Section 6, Title II, of the National Prohibition Act provides, with certain exceptions not here material, that: "No one shall manufacture, sell, purchase, transport, or prescribe any liquor without first obtaining a permit from the commissioner so to do, . . . The commissioner may prescribe the form of all permits

and applications and the facts to be set forth therein. Before any permit is granted the commissioner may require a bond in such form and amount as he may prescribe to insure compliance with the terms of the permit and the provisions of this title."

By § 29 it is further provided that any person violating the provisions of any permit or of this title, shall be punished by either fine or imprisonment, or both; and, by § 35, that a tax shall be assessed against any person responsible for an illegal sale in double the amount provided by the internal revenue law, with an additional penalty.

By regulations issued by the Commissioner in October and November, 1919,[2] every applicant for a permit for the sale or use of distilled spirits or wines for other than beverage purposes, was required to furnish either a bond with corporate or personal sureties, on Form 738, in a penal sum of from $1,000 to $100,000, computed, at specified rates, on the quantity of spirits and wine which he then had on hand or would receive in the next quarterly period; or his personal bond for the same amount, secured by the deposit of Government bonds as collateral security.

Form 738 prescribed for a surety bond — which was used by Zerbey—was conditioned, as previously stated, that the principal "shall fully and faithfully comply with all the requirements of the laws of the United States now or hereafter enacted, and regulations issued pursuant thereto respecting the sale or use of distilled spirits and wines for other than beverage purposes". The corresponding Form 738A prescribed for a collateral bond, recited the pledge of Government bonds "as security for any obligation arising hereunder," and contained, after the general condition in Form 738, a specific provision that "the said principal expressly agrees that the said bonds so deposited may be sold . . . and the proceeds applied to the payment of any internal-revenue taxes, interest, and penalties which may be due, and in satisfaction of any liabilities incurred hereunder, and the expenses of such sale, if any; and the residue, if any, paid to the said principal."

Thereafter, by Regulations No. 60,[3] which, although dated January 16, 1920, were not, it appears, published and put into effect until February 1—after the issuance of the permit to Zerbey—an

[2] T. D. 2940; T. D. 2946.
[3] T. D. 2985.

applicant for a permit to sell or use distilled spirits or wines was required to file either a surety bond on a new Form 1408 or a collateral bond on a new Form 1409; provided that if the holder of such a permit had already given a bond on Form 738 or Form 738A in a sufficient penal sum, a new bond should not be required until he was called upon to make an application for a new permit.

The Form 1408 thus prescribed for a surety bond,[4] recites that "the condition of this obligation is such that if . . . the said principal shall not violate the terms of such permit . . . or . . . any of the provisions of the National Prohibition Act and regulations promulgated thereunder as now or hereafter provided, and all other laws of the United States now or hereafter enacted respecting distilled spirits, fermented liquors, wines, or other intoxicating liquors, and will pay all taxes, assessments, fines, and penalties incurred or imposed upon him by law, then this obligation to be void, otherwise to remain in full force and effect." And Form 1409 prescribed for a collateral bond likewise provides that upon the sale of the Government's bonds pledged as security, the proceeds, shall "be applied to the payment of any internal-revenue taxes, interest, fines and penalties which may be due, and in satisfaction of any liabilities incurred hereunder and the expenses of such sale, if any; and the residue, if any, paid to said principal."

The case now presented is not that of a bond executed to the Government in a specified penal sum prescribed by statute and intended as a fixed penalty imposed for a breach of a statutory duty, which is forfeited in its full amount by a breach of the condition irrespective of the actual damage thereby caused the Government. *Clark* v. *Barnard*, 108 U. S. 436, 461; *United States* v. *Dieckerhoff*, 202 U. S. 302, 309; *United States* v. *Montell* (Taney, 47), 26 Fed. Cas. 1293, 1296. Whether Congress did or could authorize the Commissioner in fixing the form of bond to prescribe a penalty, we need not consider; for here it is plain that he did not intend that the penal sum of a surety bond on Form 738 should be a penalty or liquidated damages — in this case of $100,000—the full amount of which the United States might recover for any breach of condition, however slight, as, for example, a failure to make a record of any sale as required by the regula-

[4]Regulations 60, ed. of Feb. 1, 1920, appendix.

tions; but, on the contrary, intended that such penal sum should be the maximum amount of the obligation incurred by reason of a breach of the bond. Form 738 is unquestionably to be read in connection with Form 738A. These were prescribed by the same regulations as alternative forms of the bond which the applicant might at his election furnish. They had precisely the same object, and were intended to secure the same obligation; the one by personal sureties, the other by the deposit of collateral. Plainly it was not intended that the obligation should be greater in the one case than in the other, merely because the applicant chose to furnish personal instead of collateral security. The effect of Form 738A is that the applicant's obligation shall be discharged by the payment of any internal revenue taxes, interest, penalties and liabilities accruing to the United States by reason of a breach of the condition; and it cannot be doubted that this was intended, in like manner, to be the measure of the obligation incurred under a surety bond on the corresponding Form 738.

This view is emphasized by the consideration of the new Forms 1408 and 1409 prescribed by Regulations 60. It is clear that Form 1408 is not one for a penalty or forfeiture, but is one for indemnity merely in respect, broadly speaking, of the liabilities enumerated in Form 738A. *United States* v. *Chouteau*, 102 U. S. 603, 608. And the fact that these new regulations provided that a permit holder who had previously given a surety bond on Form 738 should not be required to give a new bond on Form 1408 until called upon to make application for a new permit, is strongly persuasive evidence that the Commissioner regarded Form 738 as of substantially the same character as Form 1408, that is, as a bond for indemnity securing the payment of the liabilities enumerated in Form 738A.

Our answer to the certified questions is that: A permit bond on Form 738 is not a bond for a penalty forfeitable in its entire amount upon a breach of condition, but is a bond for indemnity securing the payment of the internal revenue taxes, interest, penalties, and liabilities accruing to the United States by reason of the breach.

A true copy.

Test:

*Clerk, Supreme Court, U. S.*